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In The

Supreme Court of the United States

OCTOBER TERM, 1970

No. ~~1780~~ 70-236

ESTATE OF LILLIE Mac MUNN STEWART, deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Law and Financial Printing
South River, N.J. (201) 257-6850
New York, N.Y. (212) 565-6377
Philadelphia, Pa. (215) 563-5587

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No.

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W. ALAN HENDERSON, Executor,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Estate of Lillie MacMunn Stewart, Deceased, W. Alan Henderson, Executor, Petitioner, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit entered in this proceeding on January 5, 1971.

Opinions Below

The opinion of the Court of Appeals for the Third Circuit (3a)[1] reported in 436 F.2d, 1281 (3rd Cir. 1971); the order of that Court denying petitioner's petition for rehearing (1a) and the opinion of the Tax Court (21a), reported in 52 T.C. 830 (1969), appear in the Appendix hereto.

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1. All references herein designated "a" are to pages in the Appendices hereto and all designated "R" are to the certified Record.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit was entered on January 5, 1971. A motion permitting petitioner to file a petition for rehearing out of time was granted by said Court on January 21, 1971. A petition for rehearing filed pursuant to said Order was denied by order of that Court dated March 8, 1971, and this petition for certiorari was filed within ninety (90) days of that date. Jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

Questions Presented

Whether the broad administrative powers granted to the trustee by the trust instruments at issue precluded the value of the charitable remainder of the trusts from being "presently ascertainable" at decedent's death and therefore not entitled to estate tax deduction as charitable bequests.

Statutes and Regulations Involved

The provisions of Section 2055(a) of the Internal Revenue Code of 1954[2] and Section 20. 2055(a) and (b) of the Regulations thereunder are set forth in Appendix D (36a).

---

2. References to the "Code" shall mean the Internal Revenue Code of 1954 (26 U.S.C. 1964 ed.).

Statement of the Case

Since the detailed relevant facts appear in both the opinions of the Tax Court and United States Court of Appeals for the Third Circuit (appended hereto) and are not in dispute, only a brief summary of the facts will be made here.

In 1960 Lillie MacMunn Stewart created an inter vivos trust, naming a bank, now the Manufacturers Hanover Trust Company, as sole trustee. For the purposes of these proceedings, the provisions of the two trust instruments were identical, providing for the payment of trust income to Mrs. Stewart for life, then to two successive life beneficiaries. Upon the death of the last surviving life tenant, the trust property was to be distributed to named charities, all of which meet the requirements of Section 2055(a)(2) of the Internal Revenue Code of 1954. The trust agreements provided in their relevant provisions as follows:[3]

> "4. The trustee shall have the following powers, authority and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any court, namely:
>
> To retain any property herwith or hereafter placed in trust and to receive, invest and retain stocks (whether common or preferred), bonds, securities, undivided interest in any real and personal property, shares or interests in investment companies or invest-

3. For trust instruments in full, see R2, pages 9 through 30.

ment trusts, any Common Trust Fund maintained by the corporate trustee and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income . . . .

To apportion to principal or to income or in part to both, any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called 'wasting asset' or so-called 'unproductive property' or any other receipt whatsoever, to determine whether or not to amortize in whole or in part, the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation as income in whole or in part and to pay from principal or income or in part from both, any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income

and to hold property to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law, provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

* * *

12. This indenture shall be construed, regulated and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided."

Mrs. Stewart died in 1964. Because of her retained life income interest, the trust was included in her gross estate under Sec. 2036 of the Code. A charitable remainder was claimed under Sec. 2055 of the Code for the present value of the remainder interest.

The Commissioner contended that the remainder interest was not presently ascertainable because

of the administrative powers of the trustee. The Tax Court, in a decision reviewed by the full Tax Court unanimously, upheld the charitable deduction. The United States Court of Appeals for the Third Circuit, on appeal by the Commissioner, reversed and disallowed the deduction.

1. The Decision Below Determines Erroneously An Important Question of Federal Tax Law Which Should Be Settled By This Court.

A resolution by this Court of a uniform and universal standard under and by which the recognized test of "present ascertainability" can be applied, in a determination of remainder valuation for estate tax purposes, is of the utmost importance in the just administration of the federal tax laws. The obvious effect of the decision in the Court of Appeals below is the threat to the charitable deduction in the case of transfers not subject to the Tax Reform Act of 1969.[4] The possibility of disallowance on the basis of broad administrative powers will be inequitable in the case of settlors who have already established irrevocable

4. Under the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, a charitable remainder interest (passing under a will executed after October 9, 1969, from a decedent dying after December 31, 1969) is not deductible unless the trust qualifies as an "annuity trust" (under which the income beneficiary is to receive a stated dollar amount annually) or a "unitrust" (under which the income beneficiary is to receive an annual payment based on a fixed percentage of the net fair market value of the trust assets). See Section 201(d), (e) and (g) of the Tax Reform Act of 1969.

inter vivos trusts incorporating such powers as are present in this case and will certainly deny to the charitable organizations, the protection and nurturing which have so long been a foundation of our tax structure.

This Court, in the case Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), in facing the effect of a trustee's power to directly invade principal for the benefit of the life beneficiary, established the doctrine that the possibility of exercise of a direct power of invasion in favor of an income beneficiary did not preclude the deduction of a charitable remainder for estate tax purposes, where in the words of Mr. Justice Holmes, "There was no uncertainty appreciably greater than the general uncertainty that attends human affairs," (279 U.S. at p. 154). Thusly, this Court early recognized that, by the very nature of human endeavors, certain variables will affect the value of the charitable remainder in these cases.

The Court of Appeals below erroneously concluded that the standard stated in the Ithaca case, supra, was not in fact a standard at all but, merely, a limited test adapted by this Court to the facts of that case. The Court of Appeals adopted the Government's contention that this Court's decisions in the cases, Merchants Bank v. Commissioner, 320 U.S. 256 (1943); Henslee v. Union Planters Bank, 335 U.S. 595 (1949) and Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955), severely limited the standard established by the Ithaca case, supra, and had in fact resulted in guidelines requiring that even the possibility

of evasion not subject to some "ready standard" would be sufficient to disqualify a charitable deduction. Such guidelines cannot be faithfully and universally applied to either the cases this Court has previously considered, involving invasion of the principal upon the direct instructions of the settlor as represented by all of the cases cited above, or upon the question at Bar, which comes to this Court for the first time, where the trustee has no power of direct invasion, possessing only administrative powers, admittedly broad in scope, but designed and intended to permit the trustee to protect, not deplete, the trust corpus.

This follows for three reasons not fully considered by the Court of Appeals below. First, there exists not the possibility but the probability that the value of every income and remainder interest of all trusts will constantly be subject to increase and diminution by reason of the change in market conditions, subjective decision of purchase and sale made by the trustee's world currency condition and the other variables alluded to by Mr. Justice Holmes in the Ithaca case, supra. Certainly, there exists no "ready standard" to measure the effect such variables will have on any remainder interest when viewed from the date of original tax valuation. To admit this premise and require a "ready standard" for deductibility qualification would result, potentially, in no trust's qualifying for a deduction. This, neither Congress nor this Court has ever held to be a valid concept. What Justice Holmes said in the Ithaca case, supra, is quite different, for this Court, there, determined that, while certainly a standard must be

applied to method, means and extent of invasion of the principal, such standard must take into consideration the very nature of human endeavors and the resulting unknown quantity of change to be experienced in their application. In the cases following,[5] this Court has admittedly constricted and severely limited the doctrine of the Ithaca case, supra, giving rise to the confusion that now exists in this area.[6] The wisdom of this limitation has continued to concern the members of this Court as the dissenting opinion of Mr. Justice Frankfurter in the Henslee case, supra, and the dissenting opinions of Mr. Justice Reed and Mr. Justice Douglas in the Sternberger case, supra, reflect.

Secondly, in failing to clearly distinguish the different nature of the direct invasion cases as treated by this Court from the case at Bar and considering them analogous has been fatal to a proper treatment of the issue by the Court of Appeals below. In this difference lies a compelling reason for this Court to consider the issues raised by this case. All of the above-discussed cases decided by this Court dealt with powers of the trustee to divert the corpus of a trust to non-charitable life beneficiaries, specifically expressed in the trust agreement, in terms fixed by the settlor and imposing a duty on the trustee to

5. Merchants Bank v. Commissioner, supra, Henslee v. Union Planters Bank, supra, and Commissioner v. Sternberger's Estate, supra.

6. See footnote 4 for legislative clarification of this issue subsequent to December 31, 1969.

invade the corpus under certain conditions. Therein is an expressed intention of a settlor favoring the well being of the income beneficiary. In the present case, however, the exact opposite exists. The settlor does not direct invasion of the corpus and in this sense demonstrates concern for the retention of maximum value for the charitable remaindermen. The Court of Appeals below erred in considering this a power of indirect invasion.

Historically, our courts have properly held that the dispositive provisions of a trust instrument, inasmuch as they reflect the expressed intention of the settlor, shall prevail. Despite this cornerstone of our jurisprudence and despite the fact that settlors of such trusts may not now be in a position to amend such provisions, the rule of this case, as established by the Court of Appeals below, would disallow the charitable remainder deduction. This would be done on the mere possibility, however remote, that the trustee might in fact exercise the power to the detriment of the charitable remaindermen through utilization of purely administrative powers granted to protect the trust corpus from the vicissitudes of human nature and of our economy as previously referred to and directly contra to the expressed dispositive provisions of the instrument. No decision of this Court supports such a rule.

Thirdly, the Court of Appeals below erred in rejecting, as an appropriate "ready standard," the control and supervision afforded by the laws and decisions of the State of New York to the

administration of trusts in that State. The holding of that Court in this case would seemingly strike a blow at the concept of faith and confidence in the administration of trusts by trustees. For, as the petitioner has consistently argued from the inception of this case, "good faith" and actions in accordance therewith are the very foundation of trusts and trustees as conceived by our law. Omitting for the moment, a detailed discussion of the law of the State of New York and the manner which it here pertains, there is no doubt, and the Government does not argue otherwise, that the courts of New York have always held trustees to the basic standard of exercising good faith in their administration of trusts. (See Part 2 hereof for detailed discussion.) In fact, courts of every jurisdiction in our country have been consistent in requiring this standard of conduct on the actions of all trustees.

The Court of Appeals below did in fact recognize this standard but held it could not apply here because a trustee, acting from the purest of motives and utilizing such powers, could diminish the remainder interest. This is true. However, the salient point overlooked by the Court below is that, in so acting, the trustee is merely reflecting human response to changing circumstances. If the trustees' actions result in diminution of the remainder interest and if the trustee has acted in good faith favoring neither the income beneficiary nor the remainderman, the change in the remainder interest is no more than results from the constant change present in human affairs. Recognizing the one without applying the

other is fatal to a proper determination of the issues in this case. In denying this basic concept of good faith as a standard upon which the "presently ascertainable" test can be measured, the Court of Appeals below has forged a crack in the foundation of the building of high moral and ethical standards which have always been and, hopefully, will continue to be the guidelines of economical endeavor in our country. This guideline has been one our courts have always been willing and competent to effectively measure and adjudicate. Such a standard should not be discarded.

2. The Decision Below Erroneously Determined and Applied the Law of the State of New York As Same Has Been Interpreted by the Courts of that State and the United States District Court for the Southern District of New York.

The effect of the decision of the Court of Appeals below is to decide an important point of New York law having widespread tax implications. With all due deference to that Court, petitioner submits that it did so erroneously.[7] The Tax Court determined that, based on the holdings of the New York courts in a line of cases, including Matter of Talbot, 170 N.Y. Misc. 138, 9 N.Y.S. 2d 806 (Surr. Orange 1939); Matter of Heinrich, 195 Misc. 803, 90 N.Y.S. 2d 875 (Surr. Monroe 1949); Mat-

7. See also "Memorandum of the Corporate Fiduciaries Association of New York City in Support of Appellee's Petition for Rehearing and For Leave to File a brief Amicus Curiae Upon Such Rehearing," filed by Kelley, Drye, Warren, Clark, Carr & Ellis, attorneys, in this case in the Court of Appeals below and set forth in full at R8.

ter of Clark, 275 N.Y. 1 (1937); Matter of Matthews, 255 App. Div. 80, 5 N.Y.S. 2d 707, affirmed, 279 N.Y. 732, 18 N.E. 2d 683 (1958); Matter of Hubbell, 307 N.Y. 246 (1951); Matter of Dickson, 237 N.Y. 2d 572 (Surr. N.Y. 1963); Matter of Muller, 24 N.Y. 2d 336, 300 N.Y.S. 2d 341 (1969), that a trustee must exercise discretion in a prudent and equitable manner, consistent with his duty of equal loyalty to all beneficiaries. Likewise, in Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135 (1919) where the grantor of the trust retained for his life, the power to direct investments in an absolute and uncontrolled manner, the New York Court of Appeals held that the grantor was in effect the trustee and stated:

> "It is true that the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or wilfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the monies committed to his care. He had no power, under cover of an investment, to loan them to himself, (a point at issue in the case). His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust." 226 N.Y. 114 at 125.

A trustee in New York must at all times act solely for the best interest of all of the beneficiaries of the trust and is permitted to have no reason for acting otherwise. As summarized by the Court of Appeals below, the Surrogate's Court of Orange County, in Matter of Talbot, supra, held that such administrative powers "to determine items of corpus and income was to be exercised in accord with settled principles of allocation, and was meant only to protect the trustee in doubtful situations."

The Court of Appeals below suggests, however, that this policy has been changed by New York Estates, Powers and Trusts Law,[8] although recognizing that this act has no application to the case at Bar. This conclusion is simply erroneous and is graphically rejected by the decision of Judge MacMahon, in the case, Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y.. 1970) where, agreeing fully with the decision of the Tax Court in this case and holding that charitable remainders there qualified for a deduction despite the trustee's power to invest in wasting assets and allocate all cash received to either income or principal, he stated at pages 547 and 548:

> "The trusts here do not, however, grant trustees a power to invade corpus. The trustees can invest in wasting assets and can allocate cash dividends to income, but

8. The EPTL is not applicable to the trusts created by Mrs. Stewart because she died prior to its effective date (see EPTL Para. 1-1.5).

these powers must be read consistently with testator's obvious intention to grant the corpus of the trust to charity. If we were to construe these powers as an unfettered discretion to invade, and even consume, the corpus of the trust, we would be allowing the trustees the power to completely eradicate the remainder interest and therefore alter testator's plan for the distribution of her estate, without there being any direct grant of such broad discretionary power.

The New York law imposes on a trustee the duty to act with fidelity for the benefit of both the income beneficiaries and the remaindermen. If trustees were to use their power to allocate receipts in a manner that would deplete or consume the trust corpus, they would certainly be violating their equitably-imposed fiduciary duty to act in the best interest of the charitable remaindermen and the remaindermen could invoke equity to prevent or void their action or hold them personally liable for the breach of trust.

The trustees' powers, therefore, to invest in wasting assets or to allocate cash receipts to principal or income is not an indirect power of invasion because it is limited by the testator's obvious intention of granting the remainder to charity and by New York law which requires a trustee to act for the benefit of the remaindermen. The charitable remainder is ascertainable and qualifies for a deduction from gross

estate under Paragraph 2055 of the Internal Revenue Code." (Emphasis added.)

The Court of Appeals below erroneously rejected the determination of the United States District Court for the Southern District of New York in this regard.[9]

The State of New York is not within the jurisdiction of the Court of Appeals for the Third Circuit, and the Court of Appeals for the Second Circuit has not to date made a determination on the question here present nor to petitioner's knowledge is such a determination pending.[10] A real question then exists, whether under the rule of Commissioner of Internal Revenue v. Estate of Herman J. Bosch, 387 U.S. 456 (1967), in the absence of a holding of New York's highest state court or the United States Court of Appeals for that jurisdiction, left the Court of Appeals below free to disregard the decision of the United States District Court for the Southern District of New York on the impact of the New York law. We respectfully submit it does not. In that case, this Court held that, where federal estate tax liability turns

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9. The decision of the Court of Appeals below reflects in part, a mistaken view of the facts in that case (15a). The decision indicates that the Court may have been influenced by the fact that the life tenants had died and the charitable remainder already disbursed. This, however, was true of only two of the seven trusts involved therein.

10. Bankers Trust Co. v. United States, supra, is on appeal to the Court of Appeals for the Second Circuit but the Government has not appealed that case on the issues herein pertinent. See also footnote No. 5 (7a).

on character of a property interest held and transferred by decedent under state law, federal authorities are not conclusively bound by determination made of such property interest by a state trial court in proceedings in which the United States is not a party. While the decision in that case does not directly answer our inquiry here, its reasoning leads us easily to the conclusion that the Court of Appeals below should have accepted in this case the determinations of the United States District Court on the very same point in question relative to New York law, absent a determination by the Circuit Court of Appeals for the Second Circuit or the state court. This court reasoned in the Bosch case, supra, that the United States could not be bound on determinations in state courts in which it was not a party. In the Bankers Trust case, supra, the Government was a party, the issue was the same as here presented, many lower state courts had decided similar issues and, absent a higher federal court ruling, the decision of the United States Court for the Southern District of New York clearly defines and establishes New York state law for the purposes of this case. All of the criteria of the Bosch case, supra, have been satisfied and the Court of Appeals below was bound to the determination of the United States District Court in that jurisdiction. To hold otherwise would tend to create uncertainty in all interstate relationships and is not in keeping with the determination of this Court in the Bosch case. This issue, in relation to its applicability to this case, is deserving of review by this Court.

3. The Decision Below is in Conflict With the Decisions and Determinations of the United States Court of Appeals for the First Circuit and other Federal Courts.

In the administrative proceedings before the Internal Revenue Service and as recognized by the Tax Court below, the Government placed heavy reliance in asserting its position on the holding of the United States Court of Appeals for the First Circuit in State Street Trust Co., et al, v. United States, 263 F.2d 634 (C.A. 1, 1959). That Court, in considering the effect of much broader administrative powers granted to the trustee, including exculpatory provisions releasing the trustee from liability, held that the trustees were not limited by any ascertainable standard and that, therefore, the remainder interest failed the test of "present ascertainability." This petitioner has consistently argued and the Tax Court below correctly determined the basic weakness of the State Street case, supra, as expressed by Chief Judge Magruder (C.A.-1) in his dissenting opinion in that case, where he said, with obvious persuasiveness, that the majority opinion stretched the statutory language too far, when it held that a Massachusetts court could not effectively control the exercise of the granted powers and thereby created an interpretation that, when such powers were granted, they were, in reality, "rights." Judge Magruder was of the firm opinion that adequate safeguards and standards were created and maintained by the jurisdictional law of Massachusetts.

More importantly, however, petitioner submits that the Court of Appeals for the First Circuit itself specifically overruled the State Street case, supra, in Old Colony Trust Company, et al, v. United States, 423 F.2d 601 (C.A. 1, 1970).[11] In that case involving the same basic, broad administrative powers and questions as are at issue here and as were presented in the State Street case, supra, Chief Judge Aldrich said at page 602:

> ". . .If State Street Trust Co. v. United States, 1 Cir., 1959, 623 F.2d 635, was correctly decided in this aspect, the government must prevail because of the Article 7 powers . . . .
>
> . . .Trustee powers given for the administration or management of the trust must be equitably exercised, however, for the benefit of the trust as a whole. . . . The Court in State Street conceded that the powers at issue were all such powers, but reached the conclusion that, cumulatively, they gave the settlor dominion sufficiently unfettered to be in the nature of ownership. With all respect to the majority of the then court, we find it difficult to see how a power can be subject to control by the probate court, and exercisable only in what the trustee fairly

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11. The facts of the Old Colony Trust Company case, infra, do not involve charitable remainders but the issue relates directly to the effect of broad administrative powers on estate tax liability and for this purpose are directly in point.

concludes is in the interests of the trust and its beneficiaries as a whole, and at the same time be an ownership power.

The Government's position, to be sound, must be that the trustee's powers are beyond the court's control. Under Massachusetts law, however, no amount of administrative discretion prevents judicial supervision of the trustee."

The Court of Appeals below, in its decision in this case, considered only that the United States Court of Appeals for the First Circuit had qualified the State Street Trust case's decision and had done so only because of the Massachusetts' law. Petitioner respectfully submits that the true effect of the Old Colony Trust Co. case, supra, was to overrule the very facet of that case which the Court of Appeals below used in support of its reasoning and determination in this case. Petitioner's view as to the overruling of the State Street Trust case, supra, is supported by other authorities in this field.[12] There is, in fact, no difference between the laws of Massachusetts and New York as they pertain to the control and supervision of trustees in their exercise of administrative powers and the Court of Appeals below does not, in reality, or otherwise, indicate such differences.

The Court of Appeals for the First Circuit

12. See 70-1, U.S.T.C., 12,667 notations at page 83,759, and Tax Management Memorandum TMM 70-06, March 22, 1971.

has held that Massachusetts courts, because they require the trustees to act fairly and justly to all beneficiaries, have established a sufficient standard to permit satisfaction of the test of "present ascertainability" for estate tax purposes. The United States Court of Appeals for the Third Circuit, in this case, has determined in effect that in New York, whose state courts hold to the same doctrine as the Massachusetts courts, a taxpayer will be denied a deduction. These decisions constitute a basic conflict which should be resolved by this Court.

The United States Court of Appeals for the Fifth Circuit has recently decided the case, First National Bank in Palm Beach and Phillip P. O'Connell, Co-Trustees, v. United States, F.2d , 71-1 U.S.T.C. 12, 777, case No. 29453, decided May 7, 1971, and companion cases,[13] in which the same basic issue has been involved. That court has followed the erroneous reasoning of the Court of Appeals below and concluded that such administrative powers granted trustees the right and power of indirect invasion. That court relied upon the rule stated by Scott,[14] that a trustee's determination in allocating to trust receipt principal or interest is conclusive unless he has abused the discretion granted to him. Both the Courts of Appeal for Third Circuit and Fifth Circuit have, unlike

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13. See Miami Beach First National Bank v. United States, ____ F.2d ____ (C.A. 5, 1971) decided April 30, 1971, 71-1, U.S.T.C., 12,776.

14. Scott, Trusts, 3rd ed., Sec. 233.5.

the Court of Appeals for the First Circuit, overlooked what the petitioner submits to be a proper understanding and interpretation of such a rule. For it is not with such a rule that petitioner argues. The important concept to be applied is that the respective state courts will afford control and will prevent a trustee from favoring one beneficiary against the interests of the other. For a trustee to do so would be to abuse his discretion and this, the state courts will not permit. In this control and supervision lies the essential element creating and preserving the "ready standard" upon which the test of "present ascertainability" can be satisfied.

Demonstrating the confusion that has resulted from the decision of this case by the Court of Appeals below and which it is submitted will continue to manifest is the recent decision by the United States District Court, Southern District of Ohio, Western Division, in the case Estate of Harry A. Toulmin, Jr., Virginia Bernthal Toulmin, Executrix, v. United States, Fed. Supp. Case No. 3710, decided March 19, 1971, 71-1 U.S.T.C. 12,775, where that court discusses, at length, the holding of the Court of Appeals in this case and the decision of the Court of Appeals for the First Circuit in the Old Colony Trust Company case, supra. The United States District Court, in that case, was persuaded by the reasoning of the Court of Appeals for the First Circuit and recognized the conflict with the decision in this case, resolving the question between the two different decisions on a factual basis, when in fact a detail review of these cases will not indicate any ma-

terial factual difference as they pertain to the issues presented herein.

4. Public Policy Considerations Support Reversal of the Decision of the Court of Appeals Below.

The protection and nurturing of charitable organizations are a recognized facet of our entire tax structure. The charitable deduction granted in Section 2055 of the Code expresses long-established public policy and the Commissioner of Internal Revenue should not be allowed to prevent a magnanimous donor from obtaining a charitable deduction for a charitable remainder by an extended and unsupported interpretation of federal legislation on the subject.

As previously pointed out (see footnote 4), Congress, after extensive consideration in this area, revealed that the change made by the Tax Reform Act of 1969, P.L. 91-172 (83) stat. 487, had not clearly prevailed before. Thus, the provisions of the New Act have changed the law in this regard in a proper legislative manner. Congress has seen fit to draw a more stringent standard. The Government is not, however, entitled to its provisions in application to this case. A careful analysis reflects that the share a charity will actually receive in such cases is always contingent on events far more speculative than the Government fears exists in this case. For example, the trustee's selection of investments, although legal, may prove to be unwise. Recent market fluctuations have decreased the value of the corpus. Likewise, such investments may

produce high income but fail to provide an increase of capital or even provide a diminution of corpus. Viewed in this perspective, the possible reduction in the value of corpus, resulting from a trustee's impartial and lawful exercise of powers granted to him to make principal-income allocation, is not very significant.

The trustee must possess discretion to operate effectively and must exercise it properly; and if it does, and the law and equity will insure that it does, the principal is rendered ascertainable. Reference to the actual handling of the trust assets vividly demonstrates that this discretion has not been violated (32a). Truly, as in this case, the best security for a charitable remainderman lies in giving the trustee proper administrative provisions as guidelines for ensuring its discretionary authority.

Petitioner respectfully submits it is apparent from the foregoing discussion that the decision of the Court of Appeals in this case was not founded correctly on either the guidelines established by this Court or the proper determination and application of the laws of the State of New York. The decision is in conflict on the main issue with that of another United States Court of Appeals and has resulted in confusion in the lower courts and among members of the Bar active in this field. The resolution of these issues by this Court is imperative for the proper disposition of this case and for the future guidelines of our courts and Bar in their interpretation of the effect and meaning of such provisions.

Conclusion

For the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Third Circuit.

Respectfully submitted,

s/ Edwin M. Dotten, Jr.
57 Union Place
Summit, New Jersey 07901
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Of Counsel

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APPENDIX A

Sur Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 18,947

ESTATE OF LILLIE MacMUNN STEWART

v.

COMMISSIONER OF INTERNAL REVENUE

Present: Judges Hastie, McLaughlin, Freedman, Seitz, Van Dusen, Aldisert, Adams, Gibbons, Rosenn

The petition for rehearing filed by

ESTATE OF LILLIE MacMUNN STEWART

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court en banc,

Sur Petition for Rehearing

the petition for rehearing is denied.

By the Court,

s/ Alan M. Adams
Judge

Dated: 3/8/71

APPENDIX B

Opinion of the Court

(Filed 1/5/71)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 18,947

ESTATE OF LILLIE MacMUNN STEWART,
Deceased, W. ALAN HENDERSON,
Executor

v.

COMMISSIONER OF INTERNAL REVENUE,
Appellant

On Appeal From the United States Tax Court

Argued November 20, 1970

Before Hastie, Chief Judge, McLaughlin
and Adams, Circuit Judges

Adams, Circuit Judge.

Because private philanthropy is so deeply rooted in our society, Congress has been persistently confronted with the problem of resolving what types of incentives are appropriate in the Federal tax system for charitable contributions. A traditional incentive has been the allowance of a deduction in the computation of income estate, and gift taxes for amounts given to charities.[1]

1. See §§170, 2055, 2522 of the Internal Revenue Code of 1954, 26 U.S.C.A. §§170, 2055, 2522 ("the Code").

The form in which gifts may be made so as to qualify under the estate tax deduction provision is quite broad.[2] Often such bequests are made in the form of charitable remainder trusts, allowing the decedent to provide for non-charitable beneficiaries, perhaps for their lives, before the charitable remainderman receives anything. To determine the proper deduction in such cases, the Estate Tax Regulations ("the Regulations") provide for a deduction if (1) the charitable interest is "presently ascertainable, and hence severable from the non-charitable interest," and (2) viewing the circumstances as of the date of decedent's death, "the possibility that the charitable transfer will not become effective is so remote as to be negligible."[3]

The question presented on this appeal is whether the broad administrative powers here granted to the trustee by the trust instruments precluded the value of the charitable remainders of the trusts from being "presently ascertainable" at the decedent's death. Only if it is decided that the value was presently ascertainable need the further question regarding the likelihood of ex-

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2. §2055(a) "Transfers for public, charitable, and religious uses. For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers . . . (2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary or educational purposes. . . ."

3. See Estate Tax Regulations §20.2055-2(a) and (b) (Treasury Regulations 26 C.F.R. §20.2055-2(a), (b)).

ercise of the power be considered.[4]

The relevant facts in this case are not in dispute. On May 24, 1960, Lillie MacMunn Stewart created two trusts, naming what is now the Manufacturers Hanover Trust Company as sole trustee. For purposes here pertinent, the two trust instruments were identical providing that the income of the trusts be paid to decedent for life, then to her sister for life, and then to her brother-in-law for life. Upon the death of the last surviving life tenant, the corpus was to be distributed to named charities which meet the requirements of §2055(a)(2) of the Code (see footnote 2). The trust agreements provided in part as follows:

> "4. The trustee shall have the following powers, authority, and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:
>
> To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust

4. See generally, 4 Mertens, Law of Federal Gift and Estate Taxation, §28.37 at pp. 397-398 (Moskowitz Ed. 1959). Taggart Charitable Deductions for Transfers of Remainder Interests Subject to Invasion, 21 Tax L. Rev. 535, 562-3 (1966).

Fund maintained by the corporate trustee, and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income....

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called 'Wasting asset' or so-called 'unproductive property' or any other receipt receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income and to hold property

determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided."

Because the decedent retained a life estate in the two inter vivos trusts, the trusts were included in her gross estate under §2036 of the Code when she died on May 6, 1964. The estate claimed a charitable deduction for the present value of the trust remainders under §2055 of the Code. The Commissioner, however, asserted that the broad administrative powers quoted above rendered the deduction unavailable because the charitable interests were not "presently ascertainable" and there was no assurance that the charities would receive the bequest. The Tax

Court upheld the charitable deduction in an opinion reported at 52 T.C. 830 (1969), and the Government has appealed.

This case presents the first instance in which a Court of Appeals has decided whether broad administrative powers in a charitable remainder trust may allow a trustee such power to deplete corpus in favor of non-charitable life beneficiaries so as to make the value of the gift not "presently ascertainable."[5] Such problem will not arise for estates subject to the Tax Reform Act of 1969 because §§201(d), (e) and (g) of that Act require that a trust pay either a fixed dollar amount or a fixed percentage of net fair market value of the trust assets to the life beneficiaries before the charitable remainder is eligible for the deduction.[6]

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5. At least four similar cases are presently pending before the Courts of Appeals: Gardiner v. United States, F. Supp. (D. Ariz. 1969); First National Bank in Palm Beach v. United States, F. Supp. (S.D. Fla. 1969); Miami Beach First National Bank v. United States, F. Supp. (S.D. Fla. 1969); Peoples Trust Co. of Bergen County v. United States, 311 F. Supp. 1197 (D.N.J. 1970). The same question was considered in Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y. 1970), but the Government has appealed only on other issues. See also Florida National Bank at Lakeland, F. Supp. (M.D. Fla. 1970).

6. See Pub. L. 91-172, 83 Stat. 487, 560-565 (codified in §§642(c)(5), 664, 2055(c) of the Internal Revenue Code of 1954). See also H.R. Rep. No. 91-413, 91st Cong. 1st Sess. 58-60 (1969); S. Rep. No. 91-552, 91st Cong. 1st Sess. 86-91 (1969). See also §§201(f)(4)(B), (C) of the Tax Reform Act of 1969 for the detailed exceptions to application of the Act to decedents dying after 1969.

The Supreme Court has repeatedly scrutinized powers to invade corpus, holding that the possibility of invasion, not subject to some "ready standard," is sufficient to disqualify a charitable deduction. Indeed, in Henslee v. Union Planters Bank, 335 U.S. 595 (1949), the Court found the chance of invasion, on behalf of an 85 year old widow with independent income and no dependents to be "remote," but held that a power to invade corpus for the woman's "pleasure, comfort and welfare" was not subject to a standard sufficiently definite to make the amount of the charitable remainders a presently ascertainable sum.[7] This decision was based on an earlier case which similarly had held that a power to invade "for the comfort, support, maintenance and/or happiness of my ... wife," the trustee to exercise his discretion "with liberality," was too broad to constitute an "ascertainable standard" which was "fixed and capable of being stated in definite terms of money." Consequently, the Court held that the present value of the charitable remainder was not ascertainable. Merchants National Bank v. Commissioner, 320 U.S. 256, 257-258, 263 (1943).

In contrast to the foregoing cases the Supreme Court upheld a charitable deduction where the power to invade extended to amounts "that may be

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7. For an example of disallowance of the deduction because of requirement that as of the date of death, "the possibility that the charitable transfer will not become effective is so remote as to be negligible." See Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955).

necessary to suitably maintain [my wife] in as much comfort as she now enjoys." Ithaca Trust Co. v. United States, 279 U.S. 151, 154 (1929). Both the taxpayer and the Tax Court place great emphasis on the language of Mr. Justice Holmes in Ithaca Trust, supra, at 154, where he stated that the above power would not preclude a charitable deduction since the uncertainty of the amount of the gift to the charity was not "appreciably greater than the general uncertainty that attends human affairs." That statement, however, was made in the context of a finding by the Court that the above standard "was fixed in fact and capable of being stated in definite terms of money," and that the income of the trust was "more than sufficient to maintain the widow as required" by the stated standard. Mr. Justice Holmes' statement, therefore, actually amounted to determining it was very unlikely, in view of the amount of the income generated by the corpus, that principal itself would have to be invaded. As the Tax Court aptly stated below, "[a]ll trusts are subject to the vicissitudes of the economy as well as depletion through unwise, if not imprudent or unreasonable decisions on the part of the trustees." 52 T.C. at 836. If, however, invasion were to become necessary, the amounts would be subject to a readily ascertainable standard. This narrow holding has since been strictly applied by the Supreme Court in Merchants Bank, supra; Union Planters Bank, supra; and Sternberger's Estate, supra.

Taxpayer argues that none of the above cases is controlling here because they each involved

direct, dispositional powers to invade corpus, whereas Mrs. Stewart's trust agreement allows only indirect, administrative invasions of corpus. The taxpayer contends that such powers are only incidental and intended to allow the trustee to resolve doubtful cases without resorting to a court ruling or risking a surcharge. Indeed, despite the extremely broad language of the powers conferred here, taxpayer argues that New York courts would hold the trustee to a measurable and ascertainable standard.

The government contends that the possible effects of the indirect powers of invasion granted in the Stewart trusts are analogous to what the Supreme Court has condemned in the cases cited above, and that the Tax Court and the taxpayer have misconstrued the law of New York.

As this Court stated in Zentmayer's Estate v. Commissioner, 336 F.2d 488, 490 (3rd Cir. 1964), the central issue with respect to powers of invasion is "not what the trustees [are] likely to do, but what they [have] the power to do," and whether that power is limited by an ascertainable standard. In addition, the wording of the trust instrument, rather than extrinsic circumstances, must "furnish the basis for an objective standard" of ascertainability. Seubert v. Shaughnessy, 233 F.2d 134, 137 (2d Cir. 1956). Among the powers granted to the trustee in the Stewart trusts are (1) the power to invest in and to hold any type of property, including shares of investment companies and wasting assets, without the duty to diversify investments, and without regard to restrictions placed

upon fiduciaries by any rule of law; (2) the power to apportion between principal and income any accrued but unpaid income on property acquired by the trust, any dividend of whatever kind, any property received upon a corporate reorganization, consolidation, merger, or dissolution, any payment in respect of a wasting asset and "any other receipt whatsoever"; (3) the power to determine whether or not to amortize the premium at which any property may be received to depreciate any expense in connection with any property; (4) the power to discontinue any sinking fund or depreciation account and to treat the same as income; and (5) the power to pay from either principal or income any deficit from the operation of property or any charge against the trust estate. A most important item in this list is the very broad power to apportion receipts between principal and income. If the powers set forth in the trusts are literally and fully exercised, the charities might receive nothing, or an amount substantially less than that computed actuarilly.[8] For example, the trust corpus could be wholly depleted by investing in a leasehold or mineral interest, and allocating all receipts to the income account. Such result is similar to the possibilities in direct invasion cases.

The crucial question in this case thus becomes whether the ficuciary duties imposed by state law

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8. Because the estate tax must be computed at the time of death, the Regulations provide actuarial tables for computing the present value of remainder interests. See §20.2031-7 of the Regulations.

operate to restrict the trustee's exercise of the above powers in such a manner so as to insure that the amount of the charitable interest is "presently ascertainable." Cf. Peoples Trust Co. of Bergen County v. United States, 412 F.2d 1156 (3rd Cir. 1969). A fundamental concern is whether the charity might not receive benefits commensurate with the amount of the tax deduction allowed because of the terms of the trustee's powers. In this regard we must bear in mind that "the taxpayer has the burden of establishing that the amounts which will either be spent by the private beneficiary or reach the charity are thus accurately calculable." Merchants Bank, supra at 261.

In accordance with the decedent's intent specifically expressed in the trust instrument and the situs of the trusts, the parties have agreed that the laws of New York govern the administration of this trust. An early federal district court decision in New York, Colt v. Duggan, 25 F. Supp. 268 (S.D.N.Y. 1938), considered the effect of a power to allocate items between income and principal for purposes of the income tax deduction allowed for amounts paid or permanently set aside for a charitable purpose under the predecessor of §642(c) of the Code. Because of the other possibilities of invasion in the will, and later developments in New York law, the Colt case offers little guidance now.

The latest federal case construing New York law on this subject is Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y. 1970). The power complained of there was contained in Article

Seventeenth of the will:

> "All stock dividends, to the extent permitted by law, shall be treated as principal and all cash dividends, including extraordinary cash dividends, and dividends on mining stocks and other wasting investments but excluding liquidating dividends, shall be treated as income...."

Judge Lloyd F. MacMahon found that under New York law, this power would not allow the corpus to be depleted to the detriment of the charitable remaindermen without a violation of the trustees' fiduciary duties. We were informed at the oral argument in the present case that the Government has not appealed Bankers Trust on this point. Among the cases relied on by Judge MacMahon is In re Estate of Dickson, 237 N.Y.S. 2d 572, 576 (1963), where the Surrogate's Court for New York County held that an executor must act "for the best interests of all persons interested in the estate." Judge MacMahon pointed out that despite trust provisions granting the trustees investment discretion much broader than that otherwise allowed under what is now the New York Estates. Powers and Trusts Law ("EPTL" McKinney 1967), trustees are not freed from the standards of good judgment and prudence with which all trustees must act. Stated differently, "[t]he yardstick for determining the duties of a trustee is governed by the rule of the 'prudent man.'" In re Gould's Will, 234 N.Y.S.2d 825, 828 (3d Dept. 1962). See also In re Hubbell's Will, 302 N.Y. 246 (1951). Judge MacMahon's

decision may also have been influenced by the fact that the life tenants had died and the charitable remaindermen had in fact received the bequests at the time the question of the charitable deduction was litigated in the district court.

The Court in Bankers Trust could have framed its decision more narrowly, based on a precise reading of the instrument. That is, the term "dividends" used in Article Seventeenth has a specified legal meaning—generally a distribution of the earnings or profits of a corporation to its shareholders. See, for example, the highly articulated rules of EPTL §11-2(e). A distribution by a company owning wasting assets, such as a mining company, must be apportioned between income beneficiaries and remaindermen (at least in the absence of a specific grant of discretion as made in the Stewart trusts) because the income beneficiary is ordinarily entitled only to the income portion of the distribution. Matter of Hopkin's Estate, 14 N.Y.S. 2d 71 (Surr. New York 1939); In re Haldeman's Estate, 143 N.Y.S.2d 396 (Surr. New York 1955); In re McDonnell's Will, 222 N.Y.S. 2d 454 (Surr. Nassau 1961). In addition, Article Seventeenth in Bankers Trust specifically excludes "liquidating dividends" from being treated as income. This provision would appear to offer additional protection to the remainderman with respect to payouts from wasting assets. By contrast to the specific directions of allocation given in Bankers Trust, the trustee of the Stewart trusts has been given plenary power over all receipts. The grant of discretion in the Stewart trusts, therefore, is considerably broader than in Bankers Trust.

Taxpayer relies heavily on In re Talbot's Will, 9 N.Y.S. 2d 806 (1939), which the Surrogate's Court of Orange County did not permit the trustee to allocate an item to corpus rather than to income, even though a clause in the will granted the trustees broad powers "to determine" whether "any moneys, stock or securities received by them are to be considered as capital or income." The court there reasoned that where a will is the work of a competent draftsman, its provisions are to be given their strict legal connotation. Therefore, the above power granted to the trustees must be read in conjunction with the dispositive intent of the decedent in order to ascertain the dimensions of the power. Because of New York's then public policy against accumulating trust income, and because the decedent expressed no intent to overcome this policy, the court held that the power "to determine" items of corpus and income was to be exercised in accord with settled principles of allocation, and was meant only to protect the trustee in doubtful situations.

New York's present public policy on this subject is declared in its Estates, Powers and Trusts Law.[9] Section 11-2.1(a) of that law provides in part:

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9. Although the EPTL is not literally applicable to the trusts created by Mrs. Stewart because she died prior to its effective date (see EPTL §1-1.5), the provisions of §11-2.1 are essentially reenactments of New York Personal Property Law §§27-a-g (enacted April 22, 1964, effective June 1, 1965), which itself was applicable "to any receipt or expense received or incurred after [its] effective date. . . ." (Personal Property Law, §27-m). See also In re Estate of Lecompte, 276 N.Y.S. 2d 208 (Surr. Ct. N.Y. County 1966).

"(1) A trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust is so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expense is charged to income or to principal or partly to each ...(C)... in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as those entitled to principal and in view of the manner in which men of ordinary prudence, discretion, and judgment would act in the management of their own affairs.

(2) If the trust instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference that the trustee has or has not improperly exercised such discretion arises from the fact that the trustee has made an allocation contrary to the provisions of this section."

The powers of a trustee under §11-2.1(a) are so broad that a substantial question was raised in New York whether a trustee could, in effect, deprive a surviving spouse of substantially all of the income of a trust for her benefit, by the manner in which he allocated receipts and expenses.[10] This problem was solved by specific

10. See Conway, Surviving Spouse's Right of Election in New York Where Trust Income May be Divested, 34 Ford. L. Rev. 593 (1966); see also Surrogate's Association Note appended to EPTL §5-1.1 as amended in 1969.

amendment to EPTL §5-1.1—governing the rights of surviving spouses—which confers jurisdiction on the Surrogate's Court to supervise the fiduciary so as to prevent interference with the spouse's income. Otherwise, the provisions of §11-2.1(a) remain in full effect.

Thus the Government argues that the trustee for the Stewart trusts may well act with the purest motives and always in good faith, but state law will not provide any fixed and ascertainable standard of investment and management conduct for the trustee. Here the decedent's dispositive intent does not reveal any desire to favor the life tenants over the remaindermen, but decedent's administrative intent was to rely solely upon the trustee's judgment and discretion rather than upon the normal rules of state law governing the administration of trusts. Such broad powers have been previously recognized as enabling a trustee, acting safely within his prerogatives, to shift "very substantially ... the economic benefits of the trusts between the life tenants and the remaindermen," State Street Trust Co. v. United States, 263 F.2d 635, 639 (1st Cir. 1959).[11] Al-

11. We note, and fully concur with the limiting concepts expressed by Learned Hand in Stix v. Commissioner, 152 F.2d 562, 563 (2d Cir. 1945): "Nevertheless, we agree that no language, however strong, will entirely remove any power held in trust from the reach of a court of equity. After allowance has been made for every possible factor which could rationally enter into the trustee's decision, if it appears that he has utterly disregarded the interests of the beneficiary, the court will intervene. Indeed, were that not true, the power would not be held in trust at all; the language would be no more than a precatory admonition."

though the First Circuit in Old Colony Trust Co. v. United States, 423 F.2d 601 (1970) has recently qualified the State Street Trust decision as it applies to Massachusetts law, the statement quoted nonetheless remains correct with respect to New York law. The doctrine of In re Talbot's Will, supra, and In re Estate of Lecompte, supra (a trustee must always satisfy the court that the allocation was in fact prudent, if "it [is] challenged")[12] does not provide the requisite ascertainable standard for amounts left to charity where the powers are so broad as here.

Finally, taxpayer argues that the broad language employed in the trust instruments should not be literally construed because it is "mere boiler plate." However, characterizing this critical language does not help us resolve matters of taxability. The issue still persists whether the power of the trustee is limited in a measurable manner. The answer to this question for federal tax purposes cannot be determined by an inquiry into the care or carelessness of the drafter. Estate tax questions regarding powers must be answered by reference to possibilities, even though the powers granted may never be exercised.[13] Under the inquiry regarding possibilities, the amount to be received by the charities here is not "presently ascertainable."

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12. 376 N.Y.S. 2d at 210.

13. Judge Freedman aptly stated these principles in Strite v. McGinnes, 215 F.Supp. 513, 515-516 (E.D. Pa. 1963): "Boiler plate it may be, in the sense that the words may have been

(Cont'd)

Accordingly, the judgment of the Tax Court will be reversed.

A True Copy:

Test:

Clerk of the United States Court of Appeals
for the Third Circuit.

(Cont'd)

chosen indiscriminately by the scrivener without that imaginative understanding which is the hallmark of the skillful draftsman. Executors confronted with substantial tax liability because of the carefree use of words in a will, especially words which never were put to use, must view a scrutiny of their meaning as an academic intrusion into the world of reality. But we deal here with the power to consume property, regardless whether the power was exercised or lay dormant. The grant of power in the will is the test of taxability, and the reality which governs is the language of the grant rather than the extent of its exercise.

APPENDIX C

(Filed 8/14/69)

52 T. C. No. 86

TAX COURT OF THE UNITED STATES

(Same Title)

Docket No. 689-68. Filed August 14, 1969

Decedent established two inter vivos trusts with a reserved life estate, two secondary life estates, and ultimate remainders to named charities. The sole corporate trustee was given discretionary power to allocate receipts and expenditures between principal and income and to invest in wasting assets without provision for a reserve or sinking fund. Held, the discretionary powers did not constitute a power of indirect invasion in favor of the secondary life beneficiaries and the charitable remainders are deductible under sec. 2055, I.R.C. 1954.

Edwin M. Dotten, Jr., for the petitioner.

Owen A. Knopping, for the respondent.

Opinion

TANNENWALD, Judge: Respondent determined a deficiency in petitioner's estate tax in the amount of $56,308.82. The sole issue for our determination is whether the remainder interests in two trusts established by the decedent qualify for a charitable deduction pursuant to section 2055[14] because of the investment and management discretion vested in the trustee.

All of the facts are stipulated and are found accordingly.

Petitioner is the executor of the Estate of Lillie MacMunn Stewart, deceased, who died on May 6, 1964. His legal residence at the time of filing the petition herein was Madison, New Jersey. The estate tax return was filed with the District Director of Internal Revenue, Newark, New Jersey.

On May 24, 1960, the decedent created two trusts by means of separate agreements which named the Hanover Bank, a trust company and bank organized under the laws of New York, now known as the Manufacturers Hanover Trust Co., as sole trustee.

The trusts provided that the income be paid to the decedent for life, then to her sister, Ethel

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14. All references, unless otherwise specified, are to the Internal Revenue Code of 1954, as amended.

MacMunn Henderson, for life, and then to her sister's husband, W. Alan Henderson, for life. Upon the death of all the life tenants, the corpus was to be distributed to named charities, which respondent concedes meet the requirements of charitable organizations specified in Section 2055 (a)(2).

Both trust agreements are identical, except that paragraph three below appears only in the provisions governing trust A, and provide in pertinent part:

> 3. The trustee may pay or apply to or for the use of the grantor so much of the principal, even to the extent of the whole thereof, that it may in its sole discretion deem to be necessary or desirable for her support, care, comfort, and well-being.
>
> 4. The trustee shall have the following powers, authority, and discretion, which it may exercise in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:
>
> To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust Fund maintained by the corporate trustee, and any property, real or personal, foreign

or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income.

* * * *

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called "Wasting asset" or so-called "unproductive property" or any other receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute prop-

erty determined to be income and to hold property determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income;

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

* * * *

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided.

At all times between the date the trusts were established and the date of death, the assets of both trusts consisted entirely of small amounts of cash and publicly traded stocks and debt obligations of well-known business corporations and governmental agencies.

Opinion

Because of the life interest retained by the decedent, it is not disputed that the corpus of each trust was properly includable in the decedent's gross estate under Section 2036.

The sole question herein is whether the discretionary authority given the corporate trustee by the governing instruments (i.e., to allocate receipts and expenditures between principal and income and to invest in wasting assets without provision for a reserve or sinking fund) precludes the deductibility under Section 2055(a)(2)[15] of the otherwise undisputed value of the remainder interests in favor of concededly charitable organizations. Neither the efforts of the parties nor our own research has disclosed a case in which this precise question has been determined.[16]

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15. Sec. 2055. Transfers for Public, Charitable, and Regligious Uses.

(a) In General. - For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers . . . .

* * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes . . . .

16. We consider Colt v. Duggan, 25 F. Supp. 268 (S.D.N.Y. 1938), distinguishable. That case involved an income tax charitable deduction pursuant to sections 162(a) and 23(n) of the Revenue Act of 1932. In addition to the discretionary powers of allocation, the trustee also had a power directly to invade corpus for the benefit of the non-charitable income beneficiaries. The charitable remainder interests were consequently held non-deductible.

Opinion

Respondent's position is that the discretionary powers thus conferred upon the trustee were totally unrestricted and that, even if local law imposed some limitation on the free exercise of those powers, the applicable standard of conduct was not sufficiently strict and definite. He therefore asserts that they constituted a power of invasion, albeit indirect, which could be used to augment the income of the life beneficiaries. Accordingly, respondent concludes that the charitable remainders were not "presently ascertainable and hence severable," as required by Section 20.2055-2(a), Estate Tax Regulations, and that the possibility that the charitable transfers would not become effective was not "so remote as to be negligible," as required by Section 20.2055-2(b), Estate Tax Regulations.[17]

17. Section 20.2055-2. Transfers not exclusively for charitable purposes.

(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

* * *

(b) Transfers subject to a condition or a power. If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the

(Cont'd)

Opinion

Previous cases have dealt with the impact of discretionary trustee powers of direct invasion of trust corpora for the benefit of noncharitable beneficiaries and have seemingly constructed dual and mutually exclusive tests based upon the "presently ascertainable" and "so remote as to be negligible" standards of respondent's regulations. Cf. Commissioner v. Sternberger's Estate, 348 U.S. 187 (1955); Hamilton National Bank of Chattanooga v. United States, 236 F. Supp. 1005 (E.D. Tenn.), affirmed per curiam 367 F.2d 554 (C.A. 6, 1966). Compare, e.g., United States v. Commercial National Bank of Kansas City, 404 F.2d 927 (C.A. 10, 1968); Salisbury v. United States, 317 F.2d 700 (C.A. 2, 1967); Estate of Russell Harrison Varian, 47 T.C. 34, 48 (1966), affirmed per curiam 396 F.2d 753 (C.A. 9, 1968). We see no need to delve into the esoterisms involved in drawing distinctions between these two standards. See Taggart, "Charitable Deductions for Transfers of Remainder Interests Subject to Invasion," 21 Tax L. Rev. 535 (1966). As we see it, the critical question is whether the discretionary powers conferred upon the corporate trustee herein constituted a power of indirect invasion

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(Cont'd)

deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. (Emphasis added.)

* * *

as respondent contends. If that question is answered in the negative, then it would seem that each standard set forth in respondent's regulations will have been met since, aside from the existence of the discretionary powers, the remainder shares are clearly "ascertainable and hence severable" and the governing instruments create no other potentially impairing contingencies.

Both parties agree that the scope of the discretionary powers herein should be determined under New York law and have cited numerous decisions of the New York courts to support their positions. Respondent asserts that the broad powers of the trustee are at most subject to judicial interference only in the event of an arbitrary exercise thereof. Petitioner, on the other hand, claims that the trustee would be required both to act in good faith and to exercise reasonable judgment within the scope of the plan and intention of the settlor. We see no useful purpose to be served by a detailed exposition of the New York decisions, since each case dealing with the interpretation of a trustee's powers ultimately turns upon its own particular facts and is therefore distinguishable. We have concluded that petitioner's analysis is the correct one.

It is clear that the grant of discretion to a trustee, however broad, does not "relieve him from obedience to the great principles of equity which are the life of every trust." Carrier v. Carrier, 226 N.Y. 114, 123 N.E. 135, 138 (1919). Discretionary power given to a trustee to invest

in non-legals must still be exercised prudently. Matter of Bruen's Estate, 83 N.Y.S. 2d 197 (Surr. Ct. N.Y. Co. 1948); Matter of City Bank Farmers Trust Co., 189 Misc. 942, 68 N.Y.S. 2d 43 (Sup. Ct. N.Y. Co. 1947); Matter of Clark's Will, 165 Misc. 801, 1 N.Y.S. 2d 629 (Surr. Ct. Kings Co. 1938); Matter of Albro's Will, 165 Misc. 486, 300 N.Y.S. 1103 (Surr. Ct. Westchester Co. 1937). A trustee has a duty of equal loyalty to all beneficiaries. Matter of Dickson's Estate, 38 Misc. 2d 678, 237 N.Y.S. 2d 572 (Surr. Ct. N.Y. Co. 1963); Matter of Heinrich, 195 Misc. 803, 90 N.Y.S. 2d 875 (Surr. Ct. Monroe Co. 1949). As the court noted in Matter of Woodin's Estate, 118 N.Y.S. 2d 465, 469 (Surr. Ct. N.Y. Co. 1952), in summarizing the duties of a trustee:

> It is beyond dispute that the testamentary trustees owe equal duties to the income beneficiaries and the remaindermen. One obligation to the remaindermen is to safeguard the trust corpus but no obligation is owed to incur speculative risks to increase the corpus. [18] An obligation to the income

18. Compare New York Estates, Powers and Trusts Law (McKinney's), section 11-2.1(a), effective September 1, 1967, which states that "[a] trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen" and requires that, in situations not covered by the "terms of the trust instrument" or "the provisions of this section," receipts and expenditures shall be allocated "in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as those entitled to principal and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their own affairs."

> beneficiaries is to maintain the trust funds in investments that are productive of income. [5]

See also Blodget v. Delaney, 201 F.2d 589, 593-594 (C.A. 1, 1953).

The thrust of New York law is further reflected in a statutory provision declaring void any provision exonerating a fiduciary "from liability for failure to exercise reasonable care, diligence, and prudence." See New York Estates, Powers and Trusts Law (McKinney's), Section 11-1.7(a)(1), incorporating identical language previously contained in New York Decedent Estate Law (McKinney's), Section 125.

The New York cases relied upon by respondent are all distinguishable on their facts. Many of them involved the right of a trustee to invade corpus in light of the demonstrated concern of the settlor for the income beneficiary, a factor not present herein. The emphasis in some of the opinions upon a standard of arbitrariness as the measure of a trustee's responsibility occurred in the context of factual situations where the trustee was held liable for having acted arbitrarily, and thus was directed toward the negative proposition of imposing an outer limit of responsibility rather than a positive standard of conduct. The decedent herein provided, in one of the trust instruments, that the trustee might, during the term of her reserved life estate, invade the whole of the corpus opus for her "support, care, comfort and well being." No such provision appears in the other trust instrument, in which the decedent also re-

served a life estate. Nor does any such provision appear for the benefit of decedent's sister and brother-in-law, who became the income beneficiaries at decedent's death. Such a clear indication of the decedent's knowledge and use of a power of direct invasion bears heavily against interpreting discretionary powers of administration in the trustee as creating a power of indirect invasion for the benefit of the income beneficiaries, especially since there is no indication whatsoever of any intent on the part of the decedent to favor such beneficiaries at the expense of the charitable remaindermen.

We think it also significant that, at all times between the establishment of the trusts and the decedent's death, the assets of the trusts consisted entirely of small amounts of cash and publicly traded stocks and debt obligations of well-known business corporations and governmental agencies. Thus, we need not concern ourselves with situations where at the date of death there was an actual or indicated pattern of investment in wasting assets or securities involving capital gains distributions (e.g., regulated investment companies) and we specifically abjure expressing any opinion in respect thereto. Compare Rev. Rul. 67-33, 1967-1 C.B. 62, supplementing Rev. Rul. 60-385, 1960-2 C.B. 77; Rev. Rul. 60-162, 1960-1 C.B. 376.[19]

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19. We note also that Rev. Rul. 65-144, 1965-1 C.B. 442, indicates, without discussion, that a general power to apportion receipts between income and principal precludes a deduction for a charitable remainder under section 25.2522 (a)-2, Gift Tax Regulations, the provisions of which are sub-

(Cont'd)

Finally, we note that an independent third party, i.e., a bank, was named sole trustee and that the governing instruments herein expressly imposed upon the trustee a "duty to act in good faith and with reasonable care." The presence or absence of such a provision has been a critical factor in determining whether a trust in which the decedent-settlor-trustee has broad discretionary powers should be included in the gross estate under Section 2036 or Section 2038. Compare Estate of Ralph Budd, 49 T.C. 468, 475-476 (1968), and Estate of Marvin L. Pardee, 49 T.C. 140, 146, 147 (1967), in which State Street Trust Company v. United States, 263 F.2d 635 (C.A. 1, 1959), heavily relied upon by respondent herein, is distinguished. We recognize that the comparability of trust powers may differ for the purposes of Sections 2036 or 2038 as opposed to Section 2055, but the thrust of the foregoing decisions is not without significance in arriving at a decision herein.

It cannot be gainsaid that in theory the trustee herein might use its discretionary powers to allocate to income amounts that might, as an a priori matter, be technically allocable to corpus,

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(Cont'd)

stantially identical to those contained in section 20.2055-2, Estate Tax Regulations, involved herein. Aside from the fact that such ruling is not binding upon us, the ruling essentially turned on a holding that a conditional power of revocation was against public policy and that therefore the imposition of the gift tax could not be avoided. See Taggart, "Charitable Deductions for Transfers of Remainder Interests Subject to Invasion," 21 Tax L. Rev. 535, 571, n. 65 (1966).

and thereby impair the charitable remainders. But such theoretical possibility is not determinative. As Mr. Justice Holmes observed in Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), which held that the possibility of exercise of a power of invasion in favor of an income beneficiary did not preclude the deduction of a charitable remainder for estate tax purposes, "[t]here was no uncertainty appreciably greater than the general uncertainty that attends human affairs." See 279 U.S. at p. 154. We think that the same principle applies to the instant case. All trusts are subject to the vicissitudes of the economy as well as depletion through unwise, if not imprudent or unreasonable, decisions on the part of the trustees. As a consequence, a comparison of the present remainder interests with those of a trust where the trustee does not have such discretionary powers is not one of uncertainty versus certainty, but rather a comparison between degrees of uncertainty.

Cases of this type inevitably involve the difficult task of line drawing — a task which requires the placing of a particular case on one side of the line or the other, based upon an analysis of all the facts. See United States v. Dean, 224 F.2d 26, 29 (C.A. 1, 1955); Estate of Mary Cotton Wood, 39 T.C. 919, 924 (1963).

Under all the circumstances herein, we think there was no more likelihood that the corporate trustee would or could, in light of New York law, utilize its discretionary powers as a substitute power of invasion for the benefit of the income

beneficiaries than there would be in a situation where such provisions were not included in the governing instruments. Cf. William T. Grant, 48 T.C. 606, 629 (1967). Compare Rev. Rul. 69-344, I.R.B. 1969-25, 21, and Rev. Rul. 66-39, 1966-1 C.B. 223, where respondent seems to adopt a more liberal approach than the one advocated by him herein. To hold otherwise would be to turn what are commonplace trust powers intended simply to provide administrative flexibility into a substantive grant of dispositive flexibility. Compare In Re Arens, 41 N.J. 364, 197 A.2d 1 (1963); see Scott, "Principal or Income?", 100 Trusts and Estates 180, 251 (1961); Note, 61 Northwestern L. Rev. 640, 644-650 (1966). This we are not prepared to do.

We conclude, and we so find, that the charitable remainders were "presently ascertainable" and that the possibility that they would not take effect was "so remote as to be negligible." The claimed deduction should be allowed under Section 2055.

To reflect the other agreements of the parties,

Decision will be entered under Rule 50.

Reviewed by the Court.

Decision

TAX COURT OF THE UNITED STATES

(Same Title)

Pursuant to the opinion of the Court filed August 14, 1969, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That there is an overpayment in estate tax in the amount of $351.09, which amount was paid on August 20, 1965, and for which amount a claim for refund could have been filed, under the provisions of section 6511 (b)(2) of the Internal Revenue Code of 1954, on November 14, 1967, the date of the mailing of the notice of deficiency.

(Signed) THEODORE TANNENWALD, JR.

Judge.

Entered: NOV 26 1969

* * * *

APPENDIX D

Statute

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 2055. Transfers for Public, Charitable, and Religious Uses.

(a) In General.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

* * *

(2) to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation;

* * *

Regulations

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§20.2055-2 Transfers not exclusively for charitable purposes.

(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The payment value of a remainder table purpose is to be determined in accordance or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in §20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of §20.2031-7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of §20.2031.7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the

relevant instruments, may be submitted by the executor to the Commissioner, who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph §20.2031-7.

(b) Transfers subject to a condition or a power. If, as of the date of decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole, or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or

fund which is exempt from an exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the decedent consist of stock in a corporation the fiscal policies of which are controlled by the decedent and his family, that the trustees and remaindermen are likewise members of the decedent's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances no deduction will be allowed. Similarly, if the trustees are not members of the decedent's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

* * *

CERTIFICATE OF SERVICE

I, EDWIN M. DOTTEN, JR., Counsel for Petitioner herein, hereby certifies that on the day of June, 1971, I served four copies of the within Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit on the Respondent herein, the United States of America, by mailing the same postage prepaid to The Solicitor General, Department of Justice, Washington, D. C. 20530.

s/ Edwin M. Dotten, Jr.
Attorney for Petitioner

Court, U.S.
FILED
JUN 7 1971
E. ROBERT SEAVER, CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. ~~1780~~ 70-236

ESTATE OF LILLIE MAC MUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE NEW YORK STATE BANKERS ASSOCIATION, TRUST DIVISION, AND THE CORPORATE FIDUCIARIES ASSOCIATION OF NEW YORK CITY, AS *AMICI CURIAE*, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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(2) The Service's valuation tables are not specially designed for valuing trust interests. They are validly used for that purpose only because it is assumed that trustees' discretions will be impartially and fairly exercised. Only on this assumption is the value of any charitable remainder interest "presently ascertainable" 17

(3) The additional discretions conferred are not intended to favor the income beneficiaries over the charitable remaindermen. There is no reason to believe they will not be impartially and fairly exercised 18

(4) The chance that the charitable remainder here in question will not become effective is so remote as to be negligible. Its value is deductible 24

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 1780

ESTATE OF LILLIE MAC MUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE NEW YORK STATE BANKERS ASSOCIATION, TRUST DIVISION, AND THE CORPORATE FIDUCIARIES ASSOCIATION OF NEW YORK CITY, AS *AMICI CURIAE*, IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Statement of Interest of *Amici Curiae*

The New York State Bankers Association, Trust Division,[1] and The Corporate Fiduciaries Association of New

[1] The New York State Bankers Association consists of 281 state and national banks and trust companies engaged in commercial banking activities in New York. Its Trust Division has 126 members, being virtually all of the banks and trust companies actively exercising personal trust powers in the state.

York City[2] appear herein as Amici Curiae, with the consent of the parties, in representation of the beneficiaries of the many trusts their members are now and hereafter will be administering that are adversely affected by the decision of the Court of Appeals for the Third Circuit in this case.

Question in Issue

Whether charitable remainder gifts in trust after income interests are allowable charitable deductions under the various federal tax laws when the governing instrument gives the trustee more administrative discretion than state law alone would provide.

Summary of Argument

As a result of a change in its interpretation of the law in 1960, the Internal Revenue Service has since then been denying deductions for remainder interests following income interests in trusts when the governing instrument gives the trustee more administrative discretions than state law alone would provide.

The Service's attack on the deductibility of charitable remainders following income interests succeeded in Congress in 1969. In the Tax Reform Act of 1969, Congress

[2] The Corporate Fiduciaries Association of New York City is comprised of trust companies, state and national banks maintaining trust departments or engaging in fiduciary transactions which have their principal offices in the City of New York. These are Bankers Trust Company, The Chase Manhattan Bank, N.A., Chemical Bank, Fiduciary Trust Company of New York, First National City Bank, Irving Trust Company, Kings Lafayette Bank, Manufacturers Hanover Trust Company, Marine Midland Grace Trust Company of New York, Morgan Guaranty Trust Company of New York, National Bank of North America, Schroder Trust Company, The Bank of New York, Underwriters Bank and Trust Company and United States Trust Company of New York.

permitted no estate, gift or income tax charitable deduction for a charitable remainder interest following an income interest in trust. Only remainders in "charitable remainder annuity trusts" and "charitable remainder unitrusts" are deductible under the new law. However, because of the equities involved, Congress made the new rules entirely prospective in operation. The case at bar and similar cases involve a retroactive application of the Service's changed interpretation.

This court should grant the petition for certiorari to resolve conflicts in already decided cases, to provide a rule of law for the proper disposition of numerous other cases now being disputed within the Internal Revenue Service and in the courts, and to prevent difficult and extensive future litigation in the federal courts.

Extensive future litigation will be avoided if the decision below is corrected. The additional discretions conferred in the governing instrument do not materially increase the power of the trustee to shift economic interest between the beneficiaries; the settlor evidenced no intent that these additional discretions should be exercised partially; and there is no reason to believe that the trustee will use them any less fairly and impartially than its other discretions. The Service's estate tax valuation tables, which assume that all the discretions of a trustee will be impartially and fairly exercised, are therefore applicable to value the charitable remainder in question, and it is "presently ascertainable" thereunder. As the chance that this charitable remainder will not become effective is so remote as to be negligible, its value is deductible.

Argument

Background

(1) A changed interpretation of the law by the Internal Revenue Service in 1960

This case is a product of a changed interpretation of the tax law by the Internal Revenue Service announced only by the issuance of Revenue Ruling 60-385, 1960-2 Cum. Bull. 77, which held that a charitable remainder interest in trust was not presently ascertainable and severable from the noncharitable income interest when capital gains dividends of regulated investment companies were allocable to income or could in the trustee's discretion be so allocated. Prior to that time, the Service had never intimated the slightest concern that the breadth of a trustee's administrative discretion or special allocation provisions in the governing instrument might affect deductibility. In fact, in Revenue Ruling 55-620, 1955-2 Cum. Bull. 56, which Revenue Ruling 60-385 overruled, the Service had specifically held that the remainder interest was deductible whether the capital gains dividends were allocable to principal or income.

Most of the cases that have been litigated up to now involve discretionary powers to allocate receipts and disbursements between principal and income. Sometimes these powers accompany broad investment powers, as in the case at bar. However, in *Doss* v. *United States*, Civil Action 5-693 (N.D. Tex. May 20, 1971), the deduction was disallowed by the Internal Revenue Service solely on the ground that the trustee's broad discretionary investment powers would enable her to invest in assets whose returns under the Texas Trust Act would be required to be apportioned in whole or in part to the income beneficiary.

It is only now apparent that the Service's policy since 1960, when it changed its interpretation of the law, has been to attack the deductibility of all charitable remainder interests preceded by income interests in trust, whenever the trustee has been given any more administrative discretion in the governing instrument than state law alone would confer.[3]

(2) Congressional response to the Service's changed interpretation—The Tax Reform Act of 1969

The Service's attack succeeded in Congress in 1969. The Tax Reform Act of 1969 allows no estate, gift or income tax charitable deduction for a remainder interest following an income interest in trust.[4] Such trusts will hereafter sometimes be referred to as "charitable remainder income trusts" in accommodation to the terminology used in the Tax Reform Act to refer to other kinds of charitable remainder trusts. For the remainder to be deductible

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[3] Revenue Ruling 60-385, *supra*, was issued in December 1960, seven months after the irrevocable trust agreements in the case at bar were executed. The Ruling was in terms applicable only to trusts made after 1960, so its precise holding with respect to capital gains treated as income is not applicable to Mrs. Stewart's trusts. A serious tax policy question exists whether the Service's changed interpretation of the law was so extreme that the Commissioner abused his discretion in failing to announce and explain it; also, in his failure to make it entirely prospective in operation. Many wills and trust agreements prepared in all good faith that became effective, or will become effective, between January 1, 1961 and October 9, 1972 and are now or will be in litigation would have been rewritten to conform to the changed rules if the draftsmen had only known new rules were in effect and what they were.

[4] Pub. L. No. 91-172, §201 (Dec. 30, 1969), 83 Stat. 549, enacting the following provisions of the Internal Revenue Code: *Estate tax*—Int. Rev. Code §2055(e)(2)(A). *Gift tax*—Int. Rev. Code §2522(c)(2)(A). *Income tax*—Int. Rev. Code §170(f)(2)(A). Remainder interests in so-called pooled income funds, which are entirely different from the private trust arrangements here involved, are also deductible.

under the new law, the precedent interest must be in the form of an annuity ("charitable remainder annuity trust") or in the form of a specified percentage of the value of the trust principal determined at least annually ("charitable remainder unitrust").[5] Use of a definite amount or a definite mathematical formula to determine the nonexempt beneficiary's interest was apparently designed to eliminate the trustee's discretion and, therefore, insure that charity would actually receive the full benefit of the deduction allowed.[6]

Unlike the Service, Congress made the new rules apply only prospectively for estate tax purposes—to trusts and wills of decedents dying after December 31, 1969, with a grace period for irrevocable trusts established on or before October 9, 1969 and revocable trusts and wills written on or before October 9, 1969 of settlors and testators who die before October 9, 1972 without changing or republishing them.[7] In adopting these effective dates, Congress unmistakably endorsed the continued deductibility of charitable interests in charitable remainder income trusts that became effective prior to January 1, 1970 or before the end of the grace period, if applicable.[8]

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[5] Charitable remainder annuity trusts and unitrusts are defined in new Int. Rev. Code §664.

[6] One cannot help commenting, however, that in the case of the charitable remainder annuity trust, the taxable annuitant seems to receive all the protection, the charity being more than ever dependent on the trustee to act for its benefit and make other than the most conservative kinds of investments.

[7] Pub. L. No. 91-172, §201(g)(4)(A)-(E).

[8] It is important in this connection that the Tax Court's decision below in favor of the taxpayer, 52 T.C. 830, which the entire Tax Court reviewed without dissent, was handed down on August 14, 1969. *Gardiner* v. *United States* (not officially reported), 69-2 U.S. Tax Cas. Para. 12,628, 24 Am.Fed. Tax R.2d 69-6108 (D. Ariz.) had previously been decided in taxpayer's favor, on May 21, 1969.

The Present Chaotic State of the Law

It is apparent from the Service's zealous litigation of this and related cases, and its continuing administrative policy of denying the charitable deduction whenever the governing instrument grants the trustee any additional discretion over that provided by state law, that the Service is not satisfied with Congress' prospective application of its new interpretation of the law, but wishes it to be applied retroactively to as many charitable remainder income trusts as possible.

The government's success in the Court below has effectively frustrated the purpose of the grace period provided by Congress—to give affected taxpayers and their counsel reasonable time to familiarize themselves with the new law before requiring substitution of charitable remainder annuity trusts and unitrusts for existing arrangements. So strange and awkward are the new trust entities, and so technical and complex are the tax and administrative problems they create, that at this writing (June 2, 1971), final regulations have yet to be issued respecting them.

Thus, no estate planner at the present moment knows what either the old law or the new law is; and he cannot accommodate to the decision of the Court below by amending a pre-October 10, 1969 revocable trust or making a

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Thereafter, on September 2, 1969, *Miami Beach First National Bank* v. *United States* (not officially reported), 69-2 U.S. Tax Cas. Para. 12,627, 25 Am.Fed. Tax R.2d 70-1502 (S.D. Fla.), reversed, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,744, 27 Am.Fed. Tax R.2d Para. 147,565 (5th Cir. 1971) was also decided for the taxpayer. No decision in any court favoring the Service's position was handed down until 1970. Hence, the law was wholly favorable to taxpayers when the grace period provisions were first added to the Tax Reform Act by the Senate Finance Committee in its bill introduced on November 21, 1969, and when the Tax Reform Act became law.

codicil to a pre-October 10, 1969 will, for that would take him out of the grace period. Only this Court's prompt review of the decision below will resolve the old-law part of his dilemma.[9]

Reasons Why the Petition Should Be Granted

In its Petition, taxpayer cites several valid legal reasons, particularly a direct conflict between the decision of the Third Circuit in this case and the First Circuit's holding in *Old Colony Trust Company* v. *United States,* 423 F.2d 601, 70-1 U.S. Tax Cas. Para. 12,667, 25 Am.Fed. Tax R.2d 70-1549 (1st Cir. 1970). Our members fully subscribe to Petitioner's reasoning and conclusion. However, they have two particular duties to their beneficiaries that are here directly involved: first, their duty to keep trust administration expenses—specifically, litigation expenses—to a minimum; and second, their duty to resist illegal tax claims by litigation, if necessary. This brief accordingly stresses the need for prompt settlement of existing widespread controversy and avoidance of a large number of needless disputes in the future as the primary reasons why this Court should review the decision below.

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[9] If the decision of the Court below and the more recent decision of the Court of Appeals for the Fifth Circuit in *First National Bank in Palm Beach* v. *United States,* 71-1 U.S. Tax Cas. Para. 12,777 (5th Cir. May 7, 1971), are correct, the grace period was nothing but a trap for anyone who relied on it and died after October 9, 1969 and before January 5, 1971, the date of the decision below, leaving a will giving any extra discretion to the trustee.

(1) Intervention by this Court is necessary to resolve conflicts in already decided cases and provide a rule of law for the proper disposition of other cases now being disputed in administrative proceedings within the Internal Revenue Service and in court

As a result of the Service's general attack on charitable remainder income trusts, the decided cases involving the issue herein are already numerous:

First Circuit: The Tax Court decided against the government in a case involving broad discretionary allocation powers, applying Massachusetts law, in *Estate of Phyllis W. McGillicuddy,* 54 T.C. 315 (1970). The government did not appeal to the Court of Appeals which, however, cited the case with approval in *Old Colony Trust Company* v. *United States,* 423 F.2d 601, 70-1 U.S. Tax Cas. Para. 12,667, 25 Am.Fed. Tax R.2d 70-1549 (1st Cir. 1970). As petitioner states in the petition herein, the decision below conflicts directly with the *Old Colony Trust Company* case, the only possible distinction being a formal one that the cases arose under different sections of the estate tax law.

Second Circuit: Judge Lloyd F. McMahon ruled adversely to the government in a case that cannot successfully be distinguished from the case at bar, *Bankers Trust Co.* v. *United States,* 308 F.Supp. 545, 70-1 U.S. Tax Cas. Para. 12,653, 25 Am.Fed. Tax R.2d 70-1509 (S.D.N.Y. 1970—general discretionary powers under New York law), affirmed on another issue, 71-1 U.S. Tax Cas. Para. 12,748, 27 Am. Fed. Tax R.2d Para. 148,460 (2d Cir. 1971). The government not having chosen to appeal this issue in *Bankers Trust* case, Judge McMahon's ruling is the law in the Second Circuit.

Third Circuit: The case at bar. In addition, the Court of Appeals has before it on appeal *Peoples Trust Co. of Bergen County* v. *United States,* 311 F.Supp. 1197, 70-1 U.S. Tax Cas. Para. 12,658, 25 Am.Fed. Tax R.2d 70-1531

(D.N.J. 1970) (capital gains dividends from mutual funds —New Jersey law—held for taxpayer). Also arising under New Jersey law was *Marold* v. *United States,* 322 F.Supp. 664, 27 Am.Fed. Tax R.2d Para. 148,397 (D.N.J. 1970) involving broad discretionary allocation powers. The government did not appeal the court's decision in favor of the taxpayer.

Fourth Circuit: The government lost in *Greer* v. *United States,* 70-1 U.S. Tax Cas. Para. 12,690, 25 Am.Fed. Tax R.2d 70-1629 (M.D.N.C. 1970) (broad discretionary investment and allocation powers under North Carolina law). It did not appeal.

Fifth Circuit: In addition to *First National Bank in Palm Beach, supra,* the Court of Appeals has decided two other cases adversely to taxpayers, *Florida National Bank at Lakeland* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,771, 27 Am.Fed. Tax R.2d Para. 147,568 (5th Cir. April 26, 1971) (Florida law, capital gains to be included in distributions to income beneficiaries) and *Miami Beach First National Bank* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,774, 27 Am. Fed. Tax R.2d Para. 147,565 (5th Cir. April 30, 1971) (Florida law, capital gains dividends from mutual funds and broad discretionary apportionment powers.) Still another case has just been decided in this circuit in the taxpayer's favor, *Doss* v. *United States,* Civil Action 5-693 (N.D. Tex. May 20, 1971) (broad investment powers).

Sixth Circuit: The taxpayer won in *Estate of Toulmin* v. *United States,* —— F.Supp. ——, 71-1 U.S. Tax Cas. Para. 12,775, 27 Am.Fed. Tax R.2d Para. 147,560 (S.D. Ohio, March 19, 1971) (general discretionary allocation powers under Ohio law). Whether the government will appeal has not been announced.

Ninth Circuit: On appeal to the Court of Appeals is *Gardiner* v. *United States* (not officially reported), 69-2 U.S. Tax Cas. Para. 12,628, 24 Am.Fed. Tax R.2d 69-6108 (D. Ariz. May 21, 1969) (Arizona law, general discretionary allocation powers—held for taxpayer).

Our members are parties to many similar cases and have heard of numerous others throughout the country that are pending in the Tax Court and the District Courts or are being considered at some administrative level within the Internal Revenue Service. There is more than sufficient conflict, confusion and volume of decisions to warrant this Court's grant of certiorari.

(2) Intervention by this Court is necessary to prevent difficult and extensive future litigation in the federal courts

This Court should also consider the future effects of the decision below upon the administration of justice by the District and Circuit courts, for unlike this Court, they may not decline to hear cases properly brought. If the decisions of the Courts of Appeals for the Third and Fifth Circuits stand, and if the Internal Revenue Service continues to disallow charitable deductions wherever conceivable, the federal courts will be inundated by a flood of these charitable deduction cases. It will be necessary for them to try to develop, case by case, rules for determining what, if any, deviations from state laws, discretionary or otherwise, are permissible. The fact that the grant of discretion to trustees is common, that few lawyers draft identical trust agreements, that the possible deviations and combinations of deviations from 51 different bodies of local law are innumerable, and that millions of dollars of taxes and correlative losses to charity will be at stake to give impetus to litigation, makes the prospect alarming.

The charitable deduction provisions in the federal statutes demand uniformity of application throughout the country. Because of this, it does not seem possible simply to hold that any deviation from local law is automatically fatal to deductibility. Why, if the quantum of the gift to charity is the same, should a resident of one state have the benefit of the charitable deduction, and a resident of another state be denied it? Accommodating to all the state law differences on a case by case basis is a difficult and time-consuming prospect. Adoption of federal standards would be no easier in view of the wide and irreconcilable differences of opinion of informed lawyers, judges and legislators as to what constitutes principal and what constitutes income. Such intellectual exercises would in a sense be wasted, for they would have no value for the future, all the governing instruments that could be involved having already been written.[16]

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[16] The Fifth Circuit's opinion in the *First National Bank in Palm Beach* case, *supra*, provides three perfect illustrations of the problems mentioned. First, non-amortization of premiums paid on the purchase of bonds, as directed by the will, which the government in its brief and Judge Tuttle in his opinion cited as impermissible invasions of the charitable remainder interest, is the law in Florida, Fla. Statutes Ann., §690.07. In common with many other states, Florida adopted this rule in enacting the Uniform Principal and Income Act. See §6 of that Act and §7 of the Revised Uniform Principal and Income Act. Either both the government and Judge Tuttle were mistaken as to Florida law in this respect, or some sort of federal standard was being used. Judging from the tone of the Court's opinion, the latter explanation seems at least partially correct. Next, the executors had full authority, wrote the court, "to treat stock dividends . . . as income rather than as accretions to corpus, which they really are. It is recognized in the Florida law and the Uniform Principal and Income Act, Florida Statutes Annotated §690.06, that 'stock dividends should inure to the benefit of the corpus'. Stock dividends, of course, are merely a redistribution of the number of shares representing the assets of a corporation. Certainly, to the extent that stock dividends represent appreciation in the value of the underlying assets of the corporation, rather than income to it they represent accretions to principal." —— F.2d. ——, 71-1 U.S. Tax Cas. Para. 12,777 at 9047-75. This is the so-called

Finally, the issue in this case is not restricted to a relatively small group of estate and gift tax cases. No measurable portion of capital gains realized during the administration of a trust and allocated to principal can be said to be "permanently set aside for" charitable purposes, as the income tax statute, §642(c) of the Code requires, if the trustee may invest the gains in wasting assets and allocate the receipts to income, as the court below found to be a "possibility."

The issue in this case, then, affects the taxation of at least a substantial fraction, and perhaps even a majority of thousands of existing split-interest trusts to which the Tax Reform Act of 1969 does not apply. This case is of enormous practical importance not only to the public fisc but also to the charitable community on which the ultimate burden is going to fall. It involves a conflict of basic trust principles and basic tax policies of such importance and complexity that only this Court can resolve them and it should undertake to resolve them.

The Merits of Petitioner's Case

The probability of petitioner's success upon a full hearing may possibly be considered a relevant factor in determining whether to grant its petition for certiorari. Accordingly, a brief discussion of the merits of the case is now submitted.

Massachusetts rule. Yet many states follow the Pennsylvania rule, under which stock dividends are treated as income insofar as they do not impair the "intact value" of the shares when acquired by the trust. See III Scott on Trusts §§236.3, 236.6 (3d Ed. 1967). Finally, the Court stated with respect to liquidating dividends, "Obviously, the distribution of a dividend by distributing the assets of a corporation on its dissolution is a distribution of principal." (Id.) Yet the states following the Pennsylvania rule also hold liquidation proceeds apportionable in the same way as extraordinary cash and stock dividends. III Scott on Trusts, §236.10.

Two unstated and erroneous assumptions underlie the decisions of the Courts of Appeals for the Third and Fifth Circuits: First, that the discretionary powers granted in the governing instruments increase to a material or significant degree the trustee's ability to shift economic benefits from principal to income. Second, that the tables prescribed by the Service for valuing trust interests are based on some known, definite formula for valuing such interests.

(1) The additional discretions conferred do not materially increase the power of the trustee to shift economic interests between the beneficiaries

The extent to which economic interests can be shifted under discretionary apportionment powers such as those considered by the two Courts of Appeals is insignificant, compared to the power of every trustee to shift by investment choices. Professor Scott cites investment powers to support his statement that "The trustee . . . ordinarily has considerable discretion in preserving the balance between the beneficiaries." III Scott on Trusts §232 (3d Ed., 1967).[11]

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[11] Professor Scott's complete statement is as follows:

> "The trustee, however, ordinarily has considerable discretion in preserving the balance between the beneficiaries. The beneficiary entitled to the income cannot insist that the trustee should invest in securities yielding the highest rate obtainable from proper trust investments, nor on the other hand can the beneficiary entitled to the principal insist that the trustee should invest only in the very safest and most conservative of trust investments, as for example in government bonds. Indeed, if the trustee invests the whole of the trust funds in government bonds at a time when the income thereon is very small, he may conceivably be held liable to the beneficiary entitled to the income on the ground that he has unduly favored the remainderman. There is, however, no absolute rule on this matter and under some circumstances such conduct of the trustee might be justified." III Scott on Trusts, §232, p. 1896 (3d Ed., 1967).

A concrete example will demonstrate this point better than general language. On a recent date, American Telephone and Telegraph Company 7.75s of 1977 closed at 104⅝, and that Company's 2¾s of 1975 closed at 85¼.[12] These two issues are obviously equal in quality and mature in the relatively near term within two years of each other. Although their yields to maturity are approximately the same, an investment of $89,200[13] in the one or the other will, if the bonds are held to maturity, have the following widely different consequences for principal and income under the Revised Uniform Principal and Income Act §7, which has been adopted by New York in EPTL §11-2.1(f) and by most other states:

Issue Purchased	*Annual Interest Allocable to Income*	*Capital Gain (Loss) to Principal at Maturity*
7.75s of 1977	$6,587	($ 3,981)
2¾s of 1975	$2,860	$15,340

Which issue should be bought? Perhaps one, perhaps the other, perhaps neither, perhaps some of both (to offset any loss to principal) or perhaps some of the 7.75s and some I.B.M. stock. The trustee's decision will depend on a variety of factors, including the makeup of the investment portfolio as a whole, the trustee's evaluation of general economic conditions, and his duty to be impartial as between principal and income beneficiaries. But whatever

[12] Quotations are for May 20, 1971 as reported in the Wall Street Journal of May 21, 1971.

[13] For purposes of the example, it has been ignored that bonds are not traded in units of less than $1,000 face amount.

investment decision the trustee does make, he necessarily favors one class of beneficiaries over the other.[14]

Obviously, if trustees can be relied on to be impartial in investing, as they must be, trustees can also be relied upon to be impartial in making far less sophisticated and relatively inconsequential apportionment decisions, when any actual bias would be far more evident. It is also apparent that investment decisions and apportionment discretions are interrelated. In the A T & T obligations example, the trustee would feel freer to buy the 7.75s if he had the discretion to amortize the premium that the trustee has in the case at bar.

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[14] Professor Bogert uses the following language to make the same point:

> "The duty to deal impartially between income and principal beneficiaries cannot be measured precisely as to each investment transaction, for each transaction, considered by itself, will at least slightly favor one or the other beneficiary. This does not mean that a breach of trust is involved. Neither the prudent man rule nor the duty of impartiality requires that each investment transaction be considered independently of other investment transactions during the current year, or of investment results in prior years, or, for that matter, apart from investment planning for the future. For these reasons a trustee's investment actions necessarily must be judged over a period of time, upon the basis of other factors discussed in this section, and by considering related investment transactions already made and those proposed to be made. The prudence of a sale of a particular trust asset should be judged both as an independent action and as part of a larger investment transaction involving the reinvestment of the sale proceeds, under current market conditions.
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> "Each proposed investment transaction should be weighed with a view to the overall relative positions of the income beneficiary and remaindermen and the effect of the proposed transaction on those positions." Bogert, The Law of Trusts and Trustees, §612 at 47 (2d Ed., 1960, Supp. 1970).

(2) The Service's valuation tables are not specially designed for valuing trust interests. They are validly used for that purpose only because it is assumed that trustees' discretions will be impartially and fairly exercised. Only on this assumption is the value of any charitable remainder interest "presently ascertainable"

The second unstated and erroneous assumption of the Courts of Appeals is that the term "presently ascertainable", as used in the regulations, means "accurately calculable" or "measurable" when applied to interests in trust. The denial by Revenue Ruling 60-385, 1960-2 Cum. Bull. 77, *supra,* of a deduction when capital gains dividends of investment trusts may be allocated to income "since no known formula has been advanced for ascertaining the value of the charitable interest" implies that there is some such formula that the Internal Revenue Service uses to value ordinary trust income and remainder interests. Nothing could be further from the truth. The valuation formula used is nothing more special than compound interest tables combined with actuarial factors. These tables accurately value at 6% interest compounded annually (formerly at 3½% interest, compounded annually), fixed returns on money, annuities in fixed amounts, fixed sums of money payable at the end of a life and other definite payments, but they have nothing whatever to do with valuing trust interests that are dependent on the discretion of trustees. They make no adjustment for factors peculiar to trusts that have an effect on the value of interests therein. The Internal Revenue Service has informally declined on the basis of administrative convenience to consider making any sort of adjustment to reflect the fact that 6% is from 40% to 50% higher than trustees are usually able to realize for income beneficiaries. Their duties to remaindermen require them to accept a low yield on some investments. And, of course, the government's tables are completely oblivious

to the substantial differences in value of income interests in different jurisdictions adhering to the widely dissimilar Pennsylvania and Massachusetts stock dividend allocation rules.

Thus, valuation of trust interests for federal tax purposes is of a most approximate kind, completely ignoring the broad discretionary powers all trustees have. The prescribed tables apply to trusts only because the Internal Revenue Service says they do. Their application to trust interests is valid only on the assumption that the trustees' discretions will in fact be exercised fairly, sometimes in favor of the income beneficiary, no doubt, and sometimes in favor of the remaindermen, but even-handedly over-all. Only on this assumption is the value of any charitable remainder interest "presently ascertainable."

(3) The additional discretions conferred are not intended to favor the income beneficiaries over the charitable remaindermen. There is no reason to believe they will not be impartially and fairly exercised

The Court of Appeals for the Fifth Circuit also based its *First National Bank in Palm Beach* decision in part on the following false legal conclusion:

> "We have stated in the case of *The Miami Beach First National Bank* v. *United States of America,* [7-1 U.S. Tax Cas. Para. 12,776, 27 Am.Fed. Tax R. 2d Para. 147,565], it is clear that when extraordinary powers of this kind are given to the fiduciary they are intended to modify the general rule with respect to the obligations to a fiduciary to deal with an even hand with respect to the life tenant as against the remainderman when no such extraordinary powers are expressed." —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,777 at 9047-76.

The Court assumed the wrong answer to the very point to be decided. Whether the grant of extraordinary discretionary powers is made with such intent is not determinable *a priori,* but is a question of interpretation of the governing instrument.

If there is such intent, then the even-handed and balanced exercise of discretion assumed in the valuation tables would be upset; otherwise, it would not, and use of the tables would still be valid. In the case at bar, there is manifestly no intent to upset the balance. The discretionary powers were not written specially by the settlor but were the 1960 version of "model powers" prepared for the convenience of attorneys by one of our members, Manufacturers Hanover Trust Company, to give it sufficient discretion to handle the allocation questions that always arise in the administration of trusts in a practical as well as a fair way without having to go to court for instructions or approval. These "model powers" are in the governing instruments of numerous other trusts now being administered by that Company, some having charitable beneficiaries as in the case at bar. Many other members of our organizations have developed their own "model powers" that differ in detail but not in substance or purpose from Manufacturers Hanover's. These powers are not designed to and do not favor either principal or income, giving discretions the exercise of which would sometimes benefit the one and sometimes the other.[15]

[15] The discretion to invest in investment trusts and wasting assets, which would normally benefit income, is balanced by the discretion to hold trust property uninvested without liability or loss to income. Also, the power to allocate payments in respect of wasting assets to income is offset by the discretion to allocate payments in respect of unproductive property to principal. Similarly, the determination of whether to discontinue any sinking fund is balanced by the authority to amortize bond premiums and the implied power to establish depreciation and depletion reserves. The

To be contrasted are discretionary powers that are in fact designed to favor one class of beneficiaries over the other. The governing instrument may expressly authorize invasions as in *Henslee* v. *Union Planters Bank*, 335 U.S. 595 (1949), *Merchants National Bank* v. *Commissioner*, 320 U.S. 256 (1943) and *Ithaca Trust Company* v. *United States*, 279 U.S. 151 (1929). Or the governing instrument may direct the trustee to exercise the discretions in such a way as to favor the income beneficiaries or direct or permit such extreme deviations from established concepts of what constitutes principal and income as to upset the balance directly or to manifest an intention that the trustee need not act impartially.[16] The governing instrument in *Florida National Bank at Lakeland* v. *United States*, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,771, 27 Am.Fed. Tax R.2d Para. 147,568 (5th Cir. 1971), in which the trustee was directed to distribute income and capital gains to the income beneficiaries, appears to fall within this classification. Such provisions are really dispositive provisions and not mere broadenings of administrative discretions.

The instruments in the other two recent cases of the Court of Appeals for the Fifth Circuit, *Miami Beach First National Bank* v. *United States*, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,774, 27 Am.Fed. Tax R.2d Para. 147,565 (5th Cir. 1971), and *First National Bank in Palm Beach* v. *United States*, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,777 (5th Cir. 1971) evidence no intent to and do not up-

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rule authorizing the trustee to apportion accrued income at termination to the remaindermen could benefit only the charity-remaindermen.

[16] Cf. Taggart, *Charitable Deductions for Transfers of Remainder Interests Subject to Invasion*, 21 Tax L. Rev. 535, 572 (1966).

set the traditional balance.[17] The broad administrative discretions provided in them and in the case at bar have many times been held intended to benefit both principal and income, and not to be exercisable in a partial way. Two excellent and well-known recent formulations of the rule are those of the highest courts of Massachusetts and Connecticut:

> "We think the grant of power to 'decide whether accretions' are to be treated as principal or income and how expenses are to be charged, apart from its possible exculpatory effect, is primarily an administrative power authorizing the trustee in instances of doubt to use its best informed judgment in good faith in the light of what the established rules suggest to the trustee is consistent therewith. This is a means of avoiding the expense of litigation. This power may not be used to shift beneficial interests. It does not authorize favoring either the charitable or the private beneficiaries. It is of equal advantage to each in conserving the as-

[17] Allocating capital gains dividends of regulated investment companies to income, an issue in the *Palm Beach* case, would not necessarily cause an imbalance. It is the Internal Revenue Service's opposite and arbitrary rule requiring allocation to corpus that is more likely to upset the balance by unduly favoring the charitable remaindermen. See Bogert, The Law of Trusts and Trustees, §612 at 52-53 (2d Ed. 1960, Supp. 1970):

> "A clear case of partiality in connection with investments would seem to exist where the trustee buys shares in an investment trust and under the applicable law capital gains distributions by the investment trust are required to be treated as trust capital. Here the trustee is taking subnormal income yield and securing additions to trust capital and not merely the maintenance of it. Instead of buying an ordinary legal and getting perhaps 4½% income and the mere maintenance of the corpus of the trust, he is getting something like 2.8% income from the investment trust and 2.3% capital gains distributions which go to increase the value of the trust capital. The percentages used are taken from the report for 1960 made by the national association of investment trusts."

sets of the trust. In our view such a power imports no more uncertainty in the ascertainment and calculations of the value of the charitable remainders than does the contingency that the precise amount of administrative charges and of accretions over the years cannot be known in advance." *Old Colony Trust Company* v. *Silliman,* 352 Mass. 6, 11-12, 223 N.E. 2d 504, 507-08 (1967).

". . . there can be no doubt that the trustees are given no dispositive, as distinguished from administrative, powers and that they cannot, under settled law prevailing not only in Connecticut but elsewhere, exercise any of their powers for the purpose (even if well-intended) of materially altering the value of the beneficial interests under the Oakwood trust to the detriment of Oakwood as an income beneficiary. To hold otherwise would permit the trustees to give Oakwood's income in whole or in part to the beneficiaries of the Connor trust under the motivation of a purpose and desire to enrich the Connor trust at the expense of the Oakwood trust.

• • •

"The administrative powers to determine what is principal and what is gross and net income and to allocate charges to either income or principal or both are powers often conferred in wills and here were included in a number of other administrative powers grouped together generally in Article Sixteenth of the will. It certainly would constitute a violent and wholly unwarranted repudiation and reversal of heretofore settled Connecticut trust law to construe any or all of these administrative powers conferred on the trustees as powers which, separately or collectively,

authorized the trustees to destroy or cripple a charitable bequest and turn Oakwood's income over, in whole or in part, to the Connor trust, thus in effect nullifying the whole charitable purpose of the second codicil and leaving the original will as though that codicil had never existed. For the trustees so to do would be an impermissible and illegal abuse of discretion and would obviously be in violation of the settled rule that '[w]hen there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.' Restatement (Second), 1 Trusts §183. The Oakwood trust is a clear gift of 'the net income' of the trust corpus to an admitted charity. Equity would interfere to protect this charitable gift from impairment or destruction by the trustees or anyone else." *Connor* v. *Hart*, 157 Conn. 265, 273-76, 253 A.2d 9, 13-15 (1968).

New York law is clearly the same.[18]

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[18] See *Bankers Trust Co.* v. *United States*, 308 F.Supp. 545 (S.D.N.Y. 1970), *supra*; *Matter of Heinrich*, 195 Misc. 803, 90 N.Y.S.2d 805 (Sur. Ct. Monroe Co. 1949), cited with approval by the Court of Appeals in *Matter of Muller*, 24 N.Y.2d 336, 341, 248 N.E.2d 164, 166 (1969). That the adoption by New York of the Revised Uniform Principal and Income Act §2, now N.Y. EPTL §11-2.1 did not change the rule of *Matter of Talbot*, 170 Misc. 138, 9 N.Y.S.2d 806 (Sur. Ct. Orange Co. 1939), as the Court below seems to have thought, see *Estate of Frank*, N.Y.L.J. Feb. 24, 1971 at 20, col. 3 (Sur. Ct. N.Y. Co.) which involved a provision giving the executors power to "determine what is income and what is principal hereunder; and their decision in respect thereto shall be conclusive upon all parties". The Surrogate stated: "The authorization to the fiduciaries to determine what is income and what is principal is a grant of discretion to resolve matter of doubt arising from the receipt of money, stocks or securities which may either be capital or income." EPTL §5-1.1 was not enacted to prevent interference with the income of a surviving spouse by reason of the breadth of the fiduciary powers in §11-2.1, as the Court below seems to have thought, but was simply a re-enactment of a provision first added to the New York statutes in 1936, L. 1936, c. 234—long before the enactment of the EPTL—to overrule a specific decision, *Matter*

Granting discretionary powers in the governing instrument in addition to those conferred by state law as a means of facilitating the administration of trusts for the benefit of all beneficiaries thereof is in line with a now long-established trend throughout the country, clearly apparent in the steady liberalization of trust investment rules, of giving trustees ever more discretion.[19] This trend reflects a uniform judgment by the states, founded on experience, that trustees do faithfully and fairly execute the discretionary powers entrusted to them, and that the interests of all trust beneficiaries, charitable and non-charitable alike, are better served by reposing more, rather than less, confidence in them. There is no reason to believe the trustee will not exercise the discretionary powers here conferred on it other than impartially and fairly.

(4) The chance that the charitable remainder here in question will not become effective is so remote as to be negligible. Its value is deductible

Neither the government nor the court below ever asserted that there was any real likelihood that the charitable

---

of Curley, 245 App. Div. 255, 280 N.Y.S. 80 (2d Dept., 1935), aff'd without opinion, 269 N.Y. 548, 199 N.E. 665 (1935), which the Court of Appeals itself disavowed a year later in *Matter of Clark,* 275 N.Y. 1, 9 N.E.2d 753 (1937).

[19] In fact, Virginia now provides broad discretionary powers in statutory provisions that can be incorporated by reference in the governing instrument. The allocation power in Va. Code §64.1-57 (Supp. 1970) is as follows:

> "(1) The following powers in addition to all other powers granted by law may be incorporated, in whole or in part in any will or trust instrument by reference to this section:
>
> * * *
>
> "(il) To determine whether any part of the trust estate or any addition or increment hereto be income or principal, or whether any cost, charge, expenses, tax or assessment shall be charged against income or principal, or partially against income and partially against principal."

remaindermen in this case will not in fact receive the gift Mrs. Stewart intended to give. The complaint of the Service is that it has no way of computing the value of the "possibility" the charities will receive less; but it is equally impossible for it to compute the value of the at least equal "possibility" that the charity will receive more. *United States* v. *Provident Trust Co.*, 291 U.S. 272 (1934) stands for the principle that the tax law must be applied in a realistic and not a theoretical way where, as here, a legislative policy to encourage charitable gifts is involved. The chance that the charitable remainder interest here in question will not become effective is so remote as to be negligible and its value is therefore deductible. *Commissioner* v. *Sternberger's Estate*, 348 U.S. 187, 193 (1955).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1970

~~No. 1780~~ 70-236

Estate of LILLIE MAC MUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF

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IN THE

Supreme Court of the United States

October Term, 1970

No. 1780

Estate of LILLIE MAC MUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF

Statement

This Supplemental Brief is submitted to acquaint this Court of developments since the filing of the Petition. The Amici Curiae, The New York State Bankers Association (Trust Division) and The Corporate Fiduciaries Association of New York City, concur fully in the views expressed herein.

Summary of Argument

On June 9, 1971, the court below decided the *Peoples Trust Company of Bergen County* case (Appendix A) in a way directly and unmistakably in conflict with the

case at bar and with two Fifth Circuit decisions. That the cases are inconsistent is also the government's view. The government so stated in its Petition for Rehearing in *Peoples Trust* (Appendix B).

The government's position in its Petition for Rehearing (denied July 12, 1971) is that deductibility in this series of cases should not turn on state law differences. Petitioner agrees. The government claims that no deduction is allowable in any case in any state if the trustee is given any discretionary powers. Petitioner disagrees. Under this extraordinary claim of the government, which is contrary to its position during the previous forty years of its administration of the estate, gift and income tax laws, no charitable remainder following an income interest in trust would be deductible.

More than 48 docketed cases turn on the issue herein. An unknown number of additional controversies are already at some administrative stage within the Internal Revenue Service, and because of the October 9, 1972 effective date provisions of the 1969 Tax Reform Act for the estates of many decedents, further cases are bound to arise for some years to come.

Because of the squarely conflicting decisions in the circuits, the intrinsic importance of the legal issue involved and the volume of controversies governed by it, this Court should grant the Petition for Certiorari.

ARGUMENT

POINT I

The *Peoples Trust Company of Bergen County* decision of the Court of Appeals for the Third Circuit directly and unmistakably conflicts with its decision in the case at bar and with two decisions in the Fifth Circuit.

Within one week after the filing of the Petition for Certiorari herein, the Court of Appeals for the Third Circuit decided *Peoples Trust Company of Bergen County* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,786, 27 Am. Fed. Tax R.2d Para. 147,582 (3d Cir. 6/9/71, rehearing denied 7/12/71), in favor of the taxpayer. The opinion, set forth in Appendix A, squarely conflicts with the case at bar in the same Third Circuit and the decisions of the Court of Appeals for the Fifth Circuit in *Miami Beach First National Bank* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,774, 27 Am. Fed. Tax R.2d Para. 147,565 (5th Cir., April 26, 1971) and *First National Bank in Palm Beach* v. *United States,* —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,777, 27 Am. Fed. Tax R.2d Para. 147,570 (5th Cir., May 7, 1971).

With respect to the Fifth Circuit's holdings, the court in the *Peoples Trust Company* case wrote:

> "We are aware that the Fifth Circuit, in two cases arising under Florida law, has accepted much of the position advanced here by the [government] with respect to clauses similar to Article 9. The *Florida Bank at Lakeland* v. *United States,* No. 30,183 (5 Cir. April 26, 1971); *The Miami Beach First National*

Bank v. *United States*, No. 29,524 (5th Cir. April 30, 1971). The trust provisions in those cases are different than here, and the law of Florida, as set forth in those opinions, apparently differs from that of New Jersey." 71-1 U.S. Tax Cas. Para. 12,786 at 9055-5, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,643-44, Appendix A at 12a.

Pointing to *unstated* differences in the governing instruments and "apparently" different bodies of local law does not distinguish the cases; it simply emphasizes the chaotic state of the law. Taxpayers in essentially the same positions are being treated differently, and the courts are not successfully developing a rule of law to explain—let alone justify—the unequal treatment.

Chaos will be the rule just as long as the federal judiciary, inexperienced in the field, vainly tries to evaluate entire bodies of local trust law in relation to particular trust provisions to see if they "provide any fixed and ascertainable standard of investment and management conduct for the trustee." *Estate of Stewart* v. *Commissioner*, 436 F.2d 1281, 1288 (3d Cir., 1971), Petitioner's Brief, Appendix B at 3a. No such "fixed and ascertainable standard" exists in the trust law of any state. Trust law is founded on and derives its strength from the opposite concept—giving the trustee wide discretion and then holding him accountable for its proper exercise. Preservation of the respective interests of the beneficiaries accordingly does not depend on "fixed and ascertainable" rules or standards. Under trust law everywhere, a trustee must exercise *all* his powers, both investment and administrative, impartially as between principal and income beneficiaries unless the governing instrument ev-

idences a different intent.[1] The trustee has wide discretion, particularly in investing, to determine precisely how the balance among the beneficiaries is to be maintained overall. See Brief of Amici Curiae, pp. 14-16. Abuses of such discretion are reviewable and correctible by the courts. But basically, the trust system places its reliance on the good faith of men required to be disinterested and sworn to be impartial to exercise fairly the discretions entrusted to them.

POINT II

The government's position in its most recent statement concerning the legal issue in this case is that deductibility should not turn on state law differences. Petitioner agrees. The government asserts that no deduction is allowable in any state if the trustee is given any discretionary powers. Under this extraordinary claim, which contradicts the Service's own construction of the statute for 40 years, no charitable remainder following an income interest in trust is deductible.

In the *Peoples Trust Company* case, the Court of Appeals for the Third Circuit distinguished the case at bar in the following terms:

> "[Taxpayer's] first contention, that we should look only at dispositive and not at administrative provi-

[1] A different intent is quite apparent in the will in *Rand* v. *United States*, —— F.2d ——, 71-2 U.S. Tax Cas. Para. 12,797, 2 Am.Fed. Tax R.2d Para. — (2d Cir. 7/22/71) (Vermont law—held for government). The income beneficiary was given the "entire gross or net income" of the trust estate, a provision which constitutes an extreme deviation from established concepts of what constitutes principal and income, and in effect directs that principal in indeterminate amounts be diverted to the income beneficiary. Cf. *Florida National Bank at Lakeland* v. *United States*, —— F.2d ——, 71-1 U.S. Tax Cas. Para. 12,771, 27 Am. Fed. Tax R.2d Para. 147,568 (5th Cir. 1971), discussed on p. 20 of the Brief of Amici Curiae herein.

sions, is foreclosed by this court's decision in *Estate of Stewart* v. *Commissioner,* No. 18,947 (3 Cir., Jan. 5, 1971). There we held that administrative powers could give a trustee such broad discretion to select investments and to allocate receipts between income and corpus that the charitable remainder would become unascertainable. The *Stewart* trust instrument was governed by New York law, which we held did not impose any fixed and ascertainable standard to control the conduct of the trustee under its broad language. If in the instant case the trust instrument, construed as it would be in New Jersey, vested the trustee with powers to make significant diversions from corpus, and if that power were no way limited by the New Jersey law, the *Stewart* case would control." 71-7 U.S. Tax Cas. Para. 12,786 at 9055-3, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,641, Appendix A at 5a.

* * *

"Both the provisions of the trust instrument and the law of New Jersey present quite a different situation with respect to the trustee's powers than was presented in *Estate of Stewart* v. *Commissioner, supra.* Because there is not in this trust, as it would be construed in New Jersey, a power to divert the ascertainable corpus from its charitable purpose, Section 20.2055-2(b), the deduction should have been allowed. The judgment of the district court will be affirmed." 71-1 U.S. Tax Cas. Para. 12,786 at 9055-5, 27 Am. Fed. Tax R.2d Para. 147,582 at 148,644, Appendix A at 12a.

The government's Petition for Rehearing, also appended (Appendix B), which was denied by the court on July 12, 1971, pointed out that there is no significant difference

between the laws of New York and New Jersey relevant to the proper application of section 2055:

> "We submit that if New York's fiduciary law did not limit the *Stewart* trustee's invasionary powers so as to satisfy the requirements of Section 2055, New Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles. Thus, while New York trustees must satisfy New York courts that exercises of discretion were 'prudent' (*Estate of Stewart* v. *Commissioner, supra,* p. 1288; *In re Talbot's Will,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Surr., 1939)), New Jersey trustees are, at most, bound by the no more demanding standard of proving their discretionary powers were exercised 'within the bounds of a reasonable judgment.' [Appendix A at 10a.] *Russell* v. *Princeton Laboratories, Inc.,* 50 N.J. 30, 38, 231 Atl. 2d 800, 805 (1967). The decedent here, as did the decedent in *Stewart,* conferred discretionary powers upon her trustee. The New Jersey courts, of course, retain the ultimate power to intervene should a trustee abuse the discretion granted it, but the measure of deviation from normal trust practice required to establish an abuse of discretion is, in New Jersey as well as in New York, substantial. Compare, *Swetland* v. *Swetland,* 100 N.J. Eq. 196, 134 Atl. 822 (Ch., 1926), with *In re Estate of Davis,* 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct. 1967); see also III Scott, *Trusts,* § 187 (1967). (See our main brief, pp. 14-16). To be sure, there is some outer limit beyond which the trustee here cannot go without encountering judicial intervention. *Pennsylvania Co., Inc.* v. *Gillmore,* 137 N.J. Eq. 51, 43 A.2d 667 (Ch., 1945) (change of investments which would reduce life

> beneficiaries' income by over 21 to 68 percent not permissible). But, as the *Stewart* court clearly held, the protections afforded by the potential of state court intervention is alone insufficient to 'guarantee preservation of any predictable fraction of corpus for disposition' to the charitable remaindermen. *Henselee* v. *Union Planters Bank, supra,* pp. 598-599, fn. 3. The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers." Appendix B at 19a-20a. [Footnote omitted.]

Thus, the government asserts entitlement to taxes on remainders given to charity in every state whenever the decedent has "conferred discretionary powers" on the trustees. It is to adjudicate the merits of this extraordinary claim that this Court should grant the petition herein.

For if the government is right, no remainder interest in any charitable remainder income trust and no capital gains allocated to principal during the administration of such a trust are deductible. Every settlor necessarily confers broad discretionary powers on his trustee when authorizing him to invest and reinvest the trust estate. See Brief of Amici Curiae at pp. 13 (for the capital gains point) and 14-16 (for the investment point).

The government asserts that this Court's holdings in *Henslee* v. *Union Planters Bank,* 335 U.S. 595 (1949) and *Merchants Bank* v. *Commissioner,* 320 U.S. 256 (1943) are authority for its position. Appellant's Petition for Rehearing *Peoples Trust Company of Bergen County* v. *United States,* Appendix B at 15a. Only a pronouncement by this Court to that effect could induce belief. If such is

the law, the thousands of fiduciaries now administering trusts in the United States and their charitable beneficiaries are entitled to know it so that they may at least petition Congress for relief.[2] If this new concept is the law, it should in any event no longer be applied on the catch-as-catch-can basis employed by the government since 1960, but equally to all trusts whose trustees have any investment or other discretionary powers.

At the root of this case is a rejection by the Internal Revenue Service of the trust method of managing property as being insufficiently protective of the interests of the charitable beneficiaries. Those of us who have studied the centuries of evolution of the trust concept, and witnessed the single-mindedness of generation after generation of judges, lawyers and legislators to make the trust ever more fair, effective and responsive to changing needs for the good of all beneficiaries, must surmise either that the Service is not equally aware of this history or, as is more likely, that it is concerned (as a tax collector may be expected to be) more with thwarting the one in a thousand tax avoidance case involving a faithless trustee than with the overall benefit to charity in the entire run of the thousand cases.

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[2] During the legislative preliminaries to the enactment of the Tax Reform Act of 1969, Congress certainly did not believe that the government's position herein was the law. The following statement appears in both H.R. Rep. No. 94-413 (Part 1), 91st Cong., 1st Sess. 58 (1969) and Sen. Rep. No. 91-552, 91st Cong., 1st Sess. 86 (1969):

> "Present law.—Under present law, an individual may make an indirect charitable contribution by transferring property to a trust and providing that the income is to be paid to private persons for a period of time with the remainder to go to a charity. A charitable contributions deduction generally is available for the remainder interest given to charity. The amount of the deduction is based on the present value of the remainder interest which is determined by using actuarial life expectancy tables and an assumed interest rate."

The Internal Revenue Service now believes that only mathematical formulations, such as the fixed and variable annuities of the charitable remainder trusts it persuaded Congress to adopt in 1969, adequately protect the interests of a charitable remainderman as against income. But until 1960, when it made the unannounced change in its 40 year old interpretation of the law described on pages 4-5 of the Brief of Amici Curiae herein, it too accepted as sufficient the degree of protection provided by the trust system. Whatever may be the merits of the Service's new belief, the government is not entitled to non-uniform, retroactive application of it to the detriment of settlors like Mrs. Stewart, who made their gifts in all good faith, and their intended charitable beneficiaries.

POINT III

As of May 1971, there were at least 48 docketed cases throughout the country involving the issue herein, involving many millions of dollars in taxes. Many other cases are now at some administrative stage in the Internal Revenue Service.

After the Petition herein was filed, we learned that there were at least 48 docketed cases involving the issue herein with many millions of dollars in taxes at stake, as of May 1971. These are set forth in a list kept by the Office of the Chief Counsel of the Internal Revenue Service. A copy of this list is set forth in Appendix C. It is not complete. For example, *Greer* v. *United States*, 70-1 U.S. Tax Cas. Para. 12,690, 25 Am. Fed. Tax R.2d, 70-1629 (M.D.N.C., 1970), which we now understand[3] has been appealed to and argued in the Court of Appeals for

[3] At page 10 of the Brief of *Amici Curiae*, it is stated erroneously that the government did not appeal in this case.

the Fourth Circuit, is not listed. Moreover, the listing does not purport to include cases we have heard of still being considered at some administrative level within the Internal Revenue Service itself.

POINT IV

Because of the squarely conflicting decisions in the circuits, the intrinsic importance of the legal issue involved and the volume of controversies governed by it, this Court should grant the Petition for Certiorari.

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Appendix A

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 19,032

PEOPLES TRUST COMPANY OF BERGEN COUNTY,
EXECUTOR OF THE ESTATE OF DORA PLUME, *Deceased*

v.

UNITED STATES OF AMERICA,

Appellant

(D. C. Civil Action No. 947-67)

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Argued April 5, 1971

Before GANEY, VAN DUSEN and GIBBONS, *Circuit Judges*

Opinion of the Court

(Filed June 9, 1971)

GIBBONS, *Circuit Judge.*

The United States appeals from a judgment of the district court in favor of a taxpayer in an action for a refund. The plaintiff-taxpayer is the corporate executor of the estate of Dora Plume. Dora Plume died on May 5, 1964, survived by her husband. Her executor filed an estate tax return claiming a charitable deduction of $273,231.99, which

it claimed was the value of a charitable remainder in an *inter vivos* trust which Dora Plume had executed on June 9, 1960. Her will poured her residuary estate into this trust. The Commissioner of Internal Revenue disallowed the claimed charitable deduction and assessed a deficiency in estate tax of $54,207.03, plus interest. The taxpayer paid the deficiency, filed timely refund claims for tax and interest and brought suit for a refund. The United States moved for summary judgment, which was denied, and the district court entered summary judgment in favor of the plaintiff.[1]

The June 9, 1960, *inter vivos* trust named the settlor as trustee for life and reserved to her a life income. It provided, for purposes herein relevant, that upon her death the successor trustee should pay the income to settlor's husband for his life, and upon his death should pay the corpus to certain named charities, each of which qualifies as a charitable recipient under Section 2055 of the Internal Revenue Code of 1954. 26 U.S.C. §2055 (1964). The trust instrument provided that the trustee could pay or expend for the benefit of her husband "such part or parts or all of the principal of the Trust Estate as it shall judge to be necessary, in its discretion, to provide adequately for the said husband of the Settlor and for his support, maintenance, health and needs."

The United States contends that the value of the charitable remainder is unascertainable and hence not deductible[2] because of certain administrative provisions in the trust instrument which would permit the trustee to divert the

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[1] The opinion of the district court is unreported.

[2] The Treasury Regulations allow a deduction from a decedent's gross estate of the value of a charitable remainder interest only if such interest is presently ascertainable. Treas. Reg. §20.2055-2 (1958).

corpus of the charitable remainder to the non-charitable life beneficiary. These administrative provisions are:

> "[Article] 9. Capital gain dividends derived from mutual fund investments shall be considered to be income and shall be paid to the then income beneficiary in the same manner as general income of the Trust Estate.
>
> "[Article] 10. In addition to all other powers granted to the Trustee by law, the Trustee shall have the following specific powers:
>
> * * *
>
> 13. To retain, sell, invest and reinvest any or all of the Trust Estate in any real estate, mortgages, stocks, bonds or securities of recognized investment rating, which the Trustee in her discretion shall deem wise, necessary or expedient, not necessarily confining herself to legal investments.
>
> * * *
>
> F. To do all acts which the Trustee shall deem advisable without seeking the aid of any court, even though such act may not be appropriate for fiduciaries under any statutory or other rule of law or court, but for this power."

The appellant does not contend in this appeal that the dispositive provisions of the trust, including the power to invade corpus to provide adequately for the support, maintenance, health and needs of the decedent settlor's husband, render the charitable remainder unascertainable.[3]

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[3] See *Ithaca Trust Co.* v. *United States*, 279 U.S. 151 (1929). *Cf. Henslee* v. *Union Planters National Bank Trust Co.*, 335 U.S. 595 (1949); *Merchants Bank* v. *Commissioner*, 320 U.S. 256 (1943); *Peoples Trust Company of Bergen County* v. *United States*, 412 F.2d 1156 (3 Cir. 1969); *Zentmayer's Estate* v. *Commissioner*, 336 F.2d 488 (3 Cir. 1964).

Rather, it contends that the administrative power to invest in mutual funds coupled with the administrative direction that mutual fund capital gains distributions shall be treated as income gives to the trustee the uncontrolled power to divert corpus from the remainder interest to the life interest. This occurs, appellant urges, because the shareholder of a mutual fund owns a proportionate interest in the fund's undivided aggregate assets. What he pays for his share is determined by that asset value on the date of purchase. That price reflects unrealized capital appreciation of the fund holdings. When the fund subsequently realizes gain on such appreciation and distributes all or part of the realized gain the effect is a partial return of the purchase price which, if treated as income, depletes corpus.

In an economic sense there is no distinction between the purchase of stock in any corporation having appreciated but unsold assets and the purchase of stock in a mutual fund having such assets. If in the former case the corporation should realize on the appreciated asset, that realization, net after payment of the capital gains tax, would be added to earned surplus and would be available for dividends. N.J. Rev. Stat. § 14A:7-14 (1969); *National Newark & Essex Banking Co.* v. *Durant Motor Co.*, 124 N.J. Eq. 213, 1 A.2d 316 (Ch. 1938), *aff'd* 125 N.J. Eq. 435, 5 A.2d 767 (E. & A. 1939). Such dividends, received as trust income, would theoretically have the same effect on trust corpus as capital gains distributions. Indeed the purchase price of stock of any corporation may at any given time reflect earnings which have not yet been but may in the future be declared as dividends. To the extent that such earned income is reflected in the purchase price the same theoretical effect on corpus occurs when a dividend is later declared and re-

ceived as trust income. The appellant does not contend that either possibility makes a charitable remainder unascertainable. Rather, it contends that capital gains distributions of mutual funds present a unique problem because under the governing provisions of the Internal Revenue Code there is a strong incentive on the part of fund managers to pay out rather than reinvest realized capital gains.[4] Thus, the appellant argues, investment in mutual funds and the treatment as income of capital gain distributions from such funds, presents to the trustee a unique opportunity to increase distributions to a life beneficiary at the expense of a remainderman.

In response appellee contends, (1) that the court should continue to recognize the distinction, for the purpose of determining the ascertainability of a charitable remainder, between dispositive and administrative provisions in a trust instrument; (2) that the trust instrument reflects no intention on the part of the decedent settlor to favor the life beneficiary over the charitable remainderman; and (3) that the New Jersey law applicable to the trust provides sufficient control over a trustee's exercise of discretion that the possibility of the diversions conjured up by the appellant does not really exist.

Appellee's first contention, that we should look only at dispositive and not at administrative provisions, is foreclosed by this court's decision in *Estate of Stewart* v. *Commissioner*, No. 18,947 (3 Cir., Jan. 5, 1971). There we held that administrative powers could give a trustee such broad discretion to select investments and to allocate receipts

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[4] To the extent that a regulated investment company distributes capital gains income it thereby avoids corporate tax liability and passes on to its shareholders advantageously taxed long term capital gains. 26 U.S.C. §852(b)(3) (1964).

between income and corpus that the charitable remainder would become unascertainable. The *Stewart* trust instrument was governed by New York law, which we held did not impose any fixed and ascertainable standard to control the conduct of the trustee under its broad language. If in the instant case the trust instrument, construed as it would be in New Jersey, vested the trustee with powers to make significant diversions from corpus, and if that power were no way limited by the New Jersey law, the *Stewart* case would control.

It was formerly the position of the Commissioner that a charitable remainder was ascertainable whether or not the dividends representing realized capital gains of mutual funds are distributed as income to the life beneficiary or added to the corpus. Rev. Rul. 55-620, 1955-2 Cum. Bull. 56. In 1960 the Commissioner changed his position, revoking Revenue Ruling 55-620. His new position was that if the trust instrument provided or the applicable law permitted the treatment of mutual fund capital gains distributions as income payable to the life beneficiary the remainder became unascertainable. Rev. Rul. 60-385, 1960-2 Cum. Bull. 77.

At the time the trust instrument was executed, Revenue Ruling 55-620 was in effect. The decedent and her husband, in the spring of 1960, discussed with their attorney an estate plan whereby each of them would create *inter vivos* trusts leaving a life estate to the other, then to their only child, and the corpus to charitable remaindermen. The details were left to the scrivener, and there was no discussion of the provision with respect to mutual fund capital gain dividends. That provision was a standard administrative clause then in general use in that attorney's office. Decedent and her husband each had separate

estates ample for their respective needs in the modest manner in which they lived. Their daughter predeceased them.

The decedent's trust remained revocable until her death. Before her death, while she was ill, on April 21, 1964, the settlor amended the trust to name the present corporate trustee. Between January 1, 1961, the effective date of Revenue Ruling 60-385, and the date of her death, the decedent could have but did not change the provisions of the trust to conform to the Commissioner's new position. The provisions of Revenue Ruling 60-385 were not called to her attention. Since the Commissioner's new position never came to her attention no inference can be drawn respecting her dispositive intention from her failure to make a change. Revenue Ruling 60-385 is not binding as a statute or regulation. *United States* v. *Bennett*, 186 F.2d 407 (5 Cir. 1951); *Aluminum Co. of America* v. *United States*, 123 F.2d 615 (3 Cir. 1941).

The applicable Treasury Regulation, Section 20.2055-2(b) provides in part:

> "If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power."

Subsection (a) of the same regulation provides that a charitable remainder is deductible only insofar as presently ascertainable, and refers to the method of calculation of present value. There is no question that the value

of the charitable remainder was, at the time of decedent's death, ascertainable by reference to her husband's life expectancy and likely needs. The language of the Regulation quoted above is in subsection (b), captioned "Transfers subject to a condition or a power." Under the Regulation, then, the issue is whether the trustee has a power to divert corpus from the charities to the life tenant. It is not whether as a result of the trustee's investment policies the trust corpus will at the end of the life estate be greater or less than when it vested. That risk is inherent in any trust arrangement which postpones distribution, and it does not for purposes of the deduction make a charitable remainder unascertainable. *Gardiner* v. *United States*, 69-2 USTC ¶12.628 (D. Ariz. 1969); *Estate of Phyllis W. McGillicuddy*, 54 T.C. 315 (1970); *William T. Grant*, 48 T.C. 606 (1967).

We must, therefore, look to the trust instrument as it would be looked at by a New Jersey court for any such power to divert corpus. Appellant contends that a New Jersey court would find in it (1) an intention that the trustee prefer the life beneficiary, or (2) at least the absence of any legal inhibition on the trustee if it decided to do so. The intention that the trustee prefer the life beneficiary is inferred principally from the authorization in Article 9 of the trust to treat capital gain distributions from mutual funds as income.

In the context of this trust the inclusion of Article 9 is at best neutral on the issue of the settlor's intent. Because of the tax advantages referred to hereinabove many mutual funds pursue a policy of investing in securities which will result in capital appreciation rather than in income to the fund. Investment in such funds, if the capital gains distributions were to be treated as additions to

corpus, could have the effect of depriving the life beneficiary of income which other investments might have produced. Thus to the extent that the scrivener's handiwork actually reflects the settlor's intention, it reflects as much an intention to protect the life beneficiary from reduction of income for the benefit of the remainderman as an intention to prefer the former over the latter. Rather than creating a power to divert from one class to another the language is consistent with the neutral role which in New Jersey is required of trustees for successive interests. See, *e.g., In re Koretsky's Estate,* 8 N.J. 506, 86 A.2d 238 (1951); *Pennsylvania Co. For Lives and Granting Annuities* v. *Gillmore,* 137 N.J. Eq. 51, 43 A.2d 667 (Ch. 1945).

Of course the dispositive provisions of the trust authorize corpus invasions to provide for the support, maintenance and health needs of decedent's husband. That standard was found by the district court to be objectively determinable under New Jersey law, and the appellant does not on appeal contend that this finding is in error. It contends, however, that the courts of New Jersey would permit diversion to decedent's husband of sums beyond the objectively determinable standard. We do not agree.

> "A fiduciary is under a duty to act impartially as among the several beneficiaries or creditors of an estate or trust, and not to favor one over another, whether, as in the case of beneficiaries, their interests are concurrent or successive. Where the trustee is directed to pay income to a beneficiary for life with the corpus to another, he is under a duty to fairly adjust their conflicting investment interests." Clapp, *New Jersey Practice, Wills & Administration* (3d ed. 1962) §994.

Even where the provisions of a trust agreement clothe the actions of a New Jersey fiduciary with apparent finality he must stay within the bounds of a reasonable judgment in choosing between remaindermen and present beneficiaries. *Russell* v. *Princeton Laboratories, Inc.*, 50 N.J. 30, 38, 231 A.2d 800, 805 (1967). Absent a clear expression of intention by the settlor to the contrary[5] it is the duty of New Jersey trustees to deal impartially between successive beneficiaries. *In re Koretsky's Estate, supra.* In *Pennsylvania Co. for Lives and Granting Annuities* v. *Gillmore, supra* at 58, 43 A.2d at 672, the court expressed the trustee's duty thus:

> "The question before the Court must therefore be decided on the legal aspects and the question is, what is the duty of the trustee of this residuary trust? That duty, as laid down in the *Restatement of the Law of Trusts,* is 'to deal impartially' as between the successive beneficiaries, and to act 'with due regard to their respective interests.' To accomplish this result where, as in this case, the trustee is directed to pay income for life to one set of beneficiaries and at the end of that period to pay over the principal to the remaindermen, 'the trustee is under a duty' to the life tenants 'to take care not merely to preserve the trust property but to make it productive so that a reasonable income will be available for the life tenants,' and it is under a duty to the remaindermen to 'take care to preserve the trust property for them.' The trustee 'is not under a duty to the life tenants to endanger the safety of the principal in order to produce a larger

[5] Compare *In re Estate of Conway,* 50 N.J. 525, 236 A.2d 841 (1967).

> income,' but he is under a duty 'not to sacrifice income for the purpose of increasing the value of the principal.'"

The quotes within the quote are from Section 232 of the Restatement of Trusts (1935). The rule set forth is the settled law of New Jersey, and it is inconceivable that the courts of that state would permit a New Jersey trustee to pursue an investment policy designed to divert corpus from the remainderman to a life beneficiary. E.g., *Bliss* v. *Bliss*, 126 N.J. Eq. 308, 8 A.2d 705 (Ch. 1939). Particularly is this true of charitable remainders, for the protection of which the Attorney General of New Jersey is charged with special responsibilities. N.J.R.R. 4:28-4.

The provisions in the trust giving the trustee power to invade corpus to meet the life tenant's needs does not point to a different result. In the exercise of that dispositive provision a New Jersey trustee still must act as a fiduciary. The exercise of that power is limited by the life tenant's separate income. *Sibson* v. *First National Bank and Trust Co. of Paulsboro*, 64 N.J. Super. 225, 165 A.2d 800 (App. Div. 1960). A New Jersey court would not permit a trustee to circumvent his fiduciary duty to determine the life tenant's objective need by the subterfuge of making investments which would produce income and deplete corpus. By the same token a New Jersey court would not permit an investment policy which would eliminate a reasonable return in favor of capital appreciation for the remainderman. See *Commercial Trust Co.* v. *Barnard*, 27 N.J. 332, 142 A.2d 865 (1958).

Article 9 of the decedent's trust is consistent with this neutral policy. The trustee may invest in securities in which the incremental growth occurs from capital appreciation

rather than from income. If it does so, however, it must maintain a balance between the interests of the successive beneficiaries by allotting to the life beneficiary a part of the current incremental growth. If the trustee goes too far in that direction it will violate its fiduciary duty to the remainderman, and the courts will intervene. *Cf. Briel* v. *Moody,* 77 N.J. Super. 306, 186 A.2d 314 (Ch. 1962). Compare N.J. Rev. Stat. § 3A:14A-5(A)(d), enacted in 1964 in order to comply with the Commissioner's view expressed in Revenue Ruling 60-385.

We are aware that the Fifth Circuit, in two cases arising under Florida law, has accepted much of the position advanced here by the appellant with respect to clauses similar to Article 9. *The Florida Bank at Lakeland* v. *United States,* No. 30,183 (5 Cir. April 26, 1971); *The Miami Beach First National Bank* v. *United States,* No. 29,524 (5 Cir. April 30, 1971). The trust provisions in those cases are different than here, and the law of Florida, as set forth in those opinions, apparently differs from that of New Jersey.

Both the provisions of the trust instrument and the law of New Jersey present quite a different situation with respect to the trustee's powers than was presented in *Estate of Stewart* v. *Commissioner, supra.* Because there is not in this trust, as it would be construed in New Jersey, a power to divert the ascertainable corpus from its charitable purpose, Section 20.2055-2(b), the deduction should have been allowed. The judgment of the district court will be affirmed.

Appendix B

IN THE

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 19,032

PEOPLES TRUST COMPANY OF BERGEN COUNTY, EXECUTOR OF THE ESTATE OF DORA PLUME, *Deceased*,

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Appellant's Petition for Rehearing With Suggestion for Rehearing *En Banc*

To the Honorable United States Court of Appeals for the Third Circuit and the Honorable J. Cullen Ganey, Senior Judge, and Francis L. Van Dusen and John J. Gibbons, Circuit Judges thereof:

Pursuant to Rules 35(a)(1) and 40 of the Federal Rules of Appellate Procedure and Rule 2(3) of the Rules of this Court, the United States of America, appellant herein, respectfully petitions for a rehearing with a suggestion that it be heard en banc.

Appellant's Petition for Rehearing With Suggestion for Rehearing En Banc

1. The only issue in this appeal is whether the value of a charitable remainder bequest is presently ascertainable and, hence, deductible under Section 2055 of the Internal Revenue Code of 1954. In an opinion dated June 9, 1971, the Court held that the charitable remainder interest was ascertainable and affirmed the judgment of the District Court. In reaching this conclusion, the Court held that New Jersey trust law would prohibit decedent's trustee from exercising its administrative powers in such a fashion as to deplete the trust corpus and, thus, those powers did not render the remainder interest unascertainable.

This petition is filed in the view that the rationale underlying this decision is inconsistent with that upon which this Court founded its decision in *Estate of Stewart* v. *Commissioner*, 436 F. 2d 1281 (1971) (No. 17,802), petition for certiorari pending. It is respectfully submitted that the interests of clarity and consistency in this area of the tax law would be served by the Court's resolution of this inconsistency in its decisions.

2. The instant case concerns a trust under which decedent granted a life income interest to her husband and left the remainder interest to certain named charities, each of which was a qualified charitable recipient under Section 2055 of the Internal Revenue Code of 1954. (R. 3-4; Slip Op. 2.) The trustee of this charitable remainder trust was authorized to invest in any "* * * stocks * * * or securities of recognized investment rating * * *" (R. 13), an investment power which included the authority to invest in shares of mutual fund stock. New Jersey Statutes Annotated, §3A.15-17. Decedent further directed her trustee to distribute all capital gains dividends realized from mutual

fund investments to the non-charitable income beneficiary. (R. 13.) The Government argued that, because of the structure of mutual funds and the nature of tax incentives bearing upon these funds, this combination of investment authority and apportionment direction provided the trustee with a mechanism by which to deplete the trust corpus in favor of the income beneficiary. This mechanism may be illustrated as follows: Since the value of mutual fund stock is determined by the value of the assets held by the fund on the day of purchase (*Estate of Wells* v. *Commissioner*, 50 T.C. 871 (1968), aff'd sub. nom. 418 F. 2d 1302 (C.A. 6, 1969), cert. denied, 398 U.S. 950 (1970), rehearing denied, 400 U.S. 856 (1970)), the price paid may in part be attributable to unrealized capital gains in assets held by the fund. Subsequent to the trust's purchase of stock, the mutual fund may realize these gains and, in turn, distribute them to its shareholders as a capital gains distribution. Internal Revenue Code of 1954, Section 854 (b)(3). Such a distribution which, under the terms of the instant trust, *must* be distributed to the income beneficiary, reduces the value of the mutual fund shares held by the trust by the amount of the capital gains received by the trustee. (See our main brief, pp. 8-13.)

Under the well-settled construction of Section 2055 of the Internal Revenue Code of 1954 (*Henslee* v. *Union Planters Bank*, 335 U.S. 595 (1949), rehearing denied, 336 U.S. 915 (1949); *Merchants Bank* v. *Commissioner*, 320 U.S. 256 (1943); *Zentmayer's Estate* v. *Commissioner*, 336 F. 2d 488 (C.A. 3, 1964)), no deduction may be allowed for a charitable remainder bequest unless the amounts immune from the exercise of such an invasionary power may be accurately computed (*Estate of Stewart* v. *Commissioner*,

supra), a prerequisite to deduction which we urged the taxpayer could not meet. This Court, however, held that such amounts could be computed. It based this conclusion on its reading of the New Jersey fiduciary law which is applicable to decedent's trustee. Under the Court's interpretation of New Jersey law (Slip Op. 11):

> The trustee may invest in securities in which the incremental growth occurs from capital appreciation rather than from income. If it does so, however, it must maintain a balance between the interests of the successive beneficiaries by allotting to the life beneficiary a part of the current incremental growth. If the trustee goes too far in that direction it will violate its fiduciary duty to the remainderman, and the courts will intervene.

We respectfully submit that nothing in New Jersey law would operate to permit, much less require, the trustee to apportion a part of a mutual fund's capital gains distribution to trust corpus (see New Jersey Statutes Annotated, §3A:14A-2) and, further, that the Court's interpretation of New Jersey fiduciary law as providing a sufficient limitation on the trustee's powers of invasion is inconsistent with the Court's treatment of the essentially equivalent limitation imposed by New York law upon the *Stewart* trustee.

3. *Estate of Stewart* v. *Commissioner*, *supra*, involved a trust under which the trustee was granted the following powers (436 F. 2d, pp. 1283-1284):

> 4. The trustee shall have the following powers, authority, and discretion, which may exercise in its sole

and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court, namely:

To retain any property herewith or hereafter placed in trust, and to receive, invest in and retain stocks (whether common or preferred), bonds, securities, undivided interests in any real and personal property, shares or interests in investment companies or investment trusts, any Common Trust Fund maintained by the corporate trustee, and any property, real or personal, foreign or domestic, whether or not wasting assets, without any duty to diversify and without any restriction placed upon fiduciaries by any present or future applicable law, rule of court or court decision, and from time to time to hold property uninvested without liability for interest or loss of income. * * *

To apportion to principal or to income or in part to both any rents, dividends, interest or other income accrued or declared, but unpaid, in respect of any property at the time of the receipt of such property by the trustee, any dividend of whatever kind or nature, any property received upon any exchange, reorganization, recapitalization, consolidation, merger or dissolution, any rents, royalty or payment received in respect of any so-called "Wasting asset" or so-called "unproductive property" or any other receipt whatsoever, to determine whether or not to amortize in whole or in part the premium at which any property may be received or held or any depreciation on or any expense in connection with any property, real or personal, to discontinue any sinking fund or depreciation or depletion

reserve and to treat the same as income in whole or in part and to pay from principal or income or in part from both any deficit from the operation of any improved or unimproved property or any charge against the trust estate, to distribute property determined to be income and to hold property determined to be principal without liability to any person then or thereafter interested in the trust estate, upon the termination of any trust to pay any accrued rents, dividends, interest or other income, to the next estate without apportionment and in connection with the foregoing to follow or depart, in whole or in part, from any rule of law; provided that nothing herein shall authorize an illegal accumulation of income.

In all matters to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care.

12. This indenture shall be construed, regulated, and administered in all respects in accordance with the laws of the State of New York, except as otherwise herein expressly provided.

Rejecting an argument similar to that which forms the basis for the instant decision, the *Stewart* Court held that even though (436 F. 2d, p. 1288)——

> * * * the decedent's dispositive intent does not reveal any desire to favor the life tenants over the remaindermen, * * * decedent's administrative intent was to rely solely upon the trustee's judgment and discretion

rather than upon the normal rules of state law governing the administration of trusts. Such broad powers have been previously recognized as enabling a trustee, acting safely within his prerogatives, to shift "very substantially . . . the economic benefits of the trusts between the life tenants and the remaindermen," *State Street Trust Co.* v. *United States*, 263 F. 2d 635, 369 (1st Cir. 1959). Although the First Circuit in *Old Colony Trust Co.* v. *United States*, 423 F. 2d 601 (1970) has recently qualified the *State Street Trust* decision as it applies to Massachusetts law, the statement quoted nonetheless remains correct with respect to New York law. The doctrine of *In re Talbot's Will, supra*, and *In re Estate of Lecompte, supra* (a trustee must always satisfy the court that the allocation was in fact prudent, if it [is] challenged") does not provide the requisite ascertainable standard for amounts left to charity where the powers are so broad as here. (Footnotes omitted.)

4. While the powers granted the *Stewart* trustee were different from those granted this trustee and may, as the Court here intimated (Slip Op. 4-5), have been more invasionary in nature, the manner in which the Court here reached its decision does not hinge on those differences. Instead, the instant decision turns only on the New Jersey doctrines of fiduciary law which, absent a "clear expression" of an intention to favor the life beneficiary (Slip Op. 9), were read as voiding the trustee's discretionary power to deplete corpus. We submit that if New York's fiduciary law did not limit the *Stewart* trustee's invasionary powers so as to satisfy the requirements of Section 2055, New

Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles. Thus, while New York trustees must satisfy New York courts that exercises of discretion were "prudent" (*Estate of Stewart* v. *Commissioner, supra,* p. 1288; *In re Talbot's Will,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Surr., 1939)), New Jersey trustees are, at most, bound by the no more demanding standard of proving their discretionary powers were exercised "within the bounds of a reasonable judgment." (Slip Op. 9.) *Russell* v. *Princeton Laboratories, Inc.,* 50 N.J. 30, 38, 231 Atl. 2d 800, 805 (1967).* The decedent here, as did the decedent in *Stewart,* conferred discretionary powers upon her trustee. The New Jersey courts, of course, retain the ultimate power to intervene should a trustee *abuse* the discretion granted it, but the measure of deviation from normal trust practice required to establish an abuse of discretion is, in New Jersey as well as in New York, substantial. Compare, *Swetland* v. *Swetland,* 100 N.J. Eq. 196, 134 Atl. 822 (Ch., 1926), with *In re Estate of Davis,* 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct., 1967); see also III Scott, *Trusts,* §187 (1967). (See our main brief, pp. 14-16.) To be sure, there is some outer limit beyond which the trustee here cannot go without encountering judicial intervention. *Pennsylvania Co., Inc.* v. *Gillmore,* 137 N.J. Eq. 51, 43 A. 2d 667 (Ch., 1945) (change of investments which would reduce life beneficiaries' income by over 21 to 68 percent not permissible). But, as the *Stewart* court clearly

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* The court in this case was, of course, dealing with trustees whose personal interests conflicted with those of the beneficiary. The outcome of the case, we suggest, may in part reflect the court's awareness of that conflict. III Scott, *Trusts,* §187 (1967).

held, the protections afforded by the potential of state court intervention is alone insufficient to "guarantee preservation of any predictable fraction of corpus for disposition" to the charitable remaindermen. *Henslee* v. *Union Planters Bank, supra,* pp. 598-599, fn. 3. The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers.

Respectfully submitted,

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June 1971.

Appendix C

INTERNAL REVENUE SERVICE

CHIEF COUNSEL LIST OF PENDING CASES PAGE 1791 MAY 1971

Issue Number	*Counsel Office*	*Groups	*Court*	*Name of Taxpayer*	*Date of Origin*	*Docket Number*
2055.03-03	PRESENTLY ASCERTAINABLE CHARITABLE REMAINDER					
	TAX COURT DIV	*	3 CIR	STEWART L M 436 F2D1281	02-68	689-68
	REF LIT DIV	*	9 CIR	GARDINER M J	10-65	
		*	3 CIR	PEOPLES TRUST COMPANY	09-67	
		*	ED PA	DILWORTH REBA R	02-68	
		*	5 CIR	MIAMI BEACH FIRST NAT	05-68	
		*	5 CIR	FLORIDA NATIONAL BANK	06-68	
		*	ED PA	PROVIDENT NATIONAL BANK	06-69	
		*	6 CIR	LOYD DOROTHY	06-69	
		*	S OHIO	TOULMIN HARRY A	07-69	
		*	CONN	HARTFORD NATIONAL BANK	08-69	
		*	COLO	COLORADO NATIONAL BANK	09-69	
		*	ND TEX	DOSS MEEK LANE	11-69	
		*	SD ILL	BURROUGHS GORDON	01-70	
		*	ND ILL	RAIDER ELEANORE K	03-70	
		*	E MICH	DETROIT BANK & TRUST	05-70	
		*	COLO	AMERICAN NATIONAL	08-70	
		*	MD	MERCANTILE-SAFE DEPOSIT	10-70	
		*	NEBR	FIRST NATIONAL BANK	10-70	
		*	SD NY	JOHNSTON OSWALD L	10-70	
		*	SD ILL	MILLIKIN NATIONAL	11-70	
		*	R I	INDUSTRIAL NATIONAL BANK	12-70	
	BOSTON	*	TAX CT	BUNKER MARGARET P	09-70	5798-70
		*	TAX CT	ETTLINGER EVA	09-70	5956-70
		*	TAX CT	LANCASTER SOUTHWORTH	02-71	838-71
	BUFFALO	*	TAX CT	SAUER LEO	02-71	773-71
	NEW YORK CITY	*	TAX CT	JAECKER HARRY C	02-69	824-69

Appendix C (Cont'd)

INTERNAL REVENUE SERVICE

CHIEF COUNSEL LIST OF PENDING CASES PAGE 1792 MAY 1971

Issue Number	*Counsel Office*	*Groups	*Court*	*Name of Taxpayer*	*Date of Origin*	*Docket Number*
2055.03-03	PRESENTLY ASCERTAINABLE CHARITABLE REMAINDER					
		*	TAX CT	IGNATINSKY BERTHA	05-69	2055-69
		*	TAX CT	MAIR WILLIAM J	01-70	238-70
		*	TAX CT	CLAY CHARLES M	06-70	3170-70
		*	TAX CT	LAMSON LOUISE N	11-70	6974-70
	PHILADELPHIA	*	TAX CT	SPEER GEORGE I	07-69	3346-69
		*	TAX CT	GROH IDA CASTER	11-70	6907-70
		*	TAX CT	JOHNSON EMILY COOPER	12-70	7683-70
	WASHINGTON	*	TAX CT	GEIGER MARGARET MAY	12-68	6039-68
		*	TAX CT	GRISWOLD ROGER W	08-70	5091-70
	ATLANTA	*	TAX CT	BALDWIN LOUVINE M	12-70	7794-70
	JACKSONVILLE	*	TAX CT	EVANS IRVING	06-70	3442-70
		*	TAX CT	BALCH BESS D	04-71	2379-71
	CLEVELAND	*	TAX CT	REED MARTHA STECHER	04-69	1855-69
	CHICAGO	*	TAX CT	BREAULT OSCAR J EST	06-64	3022-64
		*	TAX CT	FEIGENHOLTZ H L TRANSF	09-64	4963-64
		*	TAX CT	FEIGENHOLTZ ET AL TRANSF	09-64	4964-64
	OMAHA	*	TAX CT	OBRIEN RICHARD F	02-70	733-70
		*	TAX CT	FALK PEARL H	07-70	4351-70
	LOS ANGELES	*	TAX CT	MATSON ESTATE ESTHER	07-70	4829-70
		*	TAX CT	KIME MABEL N	12-70	7645-70
	PHOENIX	*	TAX CT	WALDRON GERALD B	12-68	6012-68
	SALT LAKE CITY	*	TAX CT	KALLAS JAMES	09-70	5667-70
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In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-236

ESTATE OF LILLIE MACMUNN STEWART, Deceased, W. ALAN HENDERSON, Executor, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. 21-35) is reported at 52 T.C. 830. The opinion of the court of appeals (Pet. App. 3-20) is reported at 436 F. 2d 1281.

JURISDICTION

The judgment of the court of appeals was entered on January 5, 1971 (Pet. App. 3-20). A petition

for rehearing was denied on March 8, 1971 (Pet. App. 1-2). The petition for a writ of certiorari was filed on June 3, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether charitable remainder interests in trusts created by the decedent qualified for federal estate tax deduction under Section 2055 of the Internal Revenue Code of 1954 (prior to its amendment by the Tax Reform Act of 1969) and the applicable Treasury Regulations, notwithstanding the trustee's unrestricted discretionary powers to invade corpus for the benefit of the income beneficiaries.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Section 2055(a) of the Internal Revenue Code of 1954 and Section 20.2055-2 of the Treasury Regulations on Estate Tax (1954 Code) are set forth in Appendix D to the petition (pp. 37a-40a).

STATEMENT

On May 24, 1960, decedent created two trusts, naming as trustee the Manufacturers Hanover Trust Company of New York. Both trust instruments provided that the income be paid to the decedent for life, then to her sister for life, and then to her sister's husband for life. Upon the death of the last surviving life tenant, the corpus was to be distributed to named charitable organizations.

Each trust instrument vested in the trustee the following powers, among others, to be exercised "in its sole and absolute discretion whenever and as often as it may deem advisable without application to or approval by any Court": (1) the power to invest in and to hold any type of property, including shares of investment companies and wasting assests, without the duty to diversify investments and without regard to restrictions placed upon fiduciaries by any rule of law; (2) the power to apportion between principal and income any accrued but unpaid income on property acquired by the trust, any dividend of whatever kind, any property received upon a corporate reorganization, consolidation, merger, or dissolution, any payment in respect of a wasting asset, and "any other receipt whatsoever"; (3) the power to determine whether or not to amortize the premium at which any property might be received, and to depreciate any expense in connection with any property; (4) the power to discontinue any sinking fund or depreciation account, and to treat the same as income; and (5) the power to pay from either principal or income any deficit from the operation of any property, or any charge against the trust estate. In addition, decedent empowered her trustee "to administer and invest the trust estate as fully and freely as an individual owner might do, without any restrictions to which fiduciaries are ordinarily subject, except the duty to act in good faith and with reasonable care." Finally, decedent provided that the trust instruments should be construed and administered ac-

cording to the laws of the State of New York. (Pet. App. 5-7.)

Decedent died on May 6, 1964. Because she retained a life interest in the two inter vivos trusts, the value of the corpus of each trust was included in her gross estate under Section 2036 of the Internal Revenue Code, and that inclusion is not in dispute. The estate, however, claimed a charitable deduction under Section 2055 for the date of death value of the two trust remainders. The Commissioner determined that the broad administrative powers vested in the trustee prevented the charitable remainder interests from being "presently ascertainable" within the meaning of Section 20.2055-2 of the Regulations, and therefore disallowed the deduction. The Tax Court overruled the Commissioner's determination, holding that although the powers contained in the trust instruments on their face were effective to permit the trustee to divert portions of corpus to the non-charitable income beneficiaries, the exercise of these powers was so restricted by the fiduciary duties imposed by New York law that no diminution of corpus would actually be allowed by the courts of that state. The court of appeals upheld the Commissioner's determination, holding that the Tax Court had erroneously interpreted New York law, which in fact offered no guarantee of protection for trust corpus against administrative erosion where, as here, the grantor vested in her trustee the broadest latitude of discretion precisely in order to insulate the trustee against litigation by the trust beneficiaries. (Pet. App. 7-8, 16-19, 21-35.)

ARGUMENT

The decision below is correct, and in accord with decisions of this Court and other courts of appeals. There is no conflict, and the decision turns largely upon a proper construction of state (here New York) law governing the administrative powers of a fiduciary. Moreover, the issue presented has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969.

1. The principles governing estate tax deductibility of charitable bequests of remainder interests have been enunciated and reiterated in a series of decisions by this Court upholding the long-standing Treasury Regulations on the subject. Under the Regulations and decisions the bequest does not qualify for deduction unless (1) the charitable interest is "presently ascertainable, and hence severable from the noncharitable interest" (Regulations Section 20.2055-2(a)), *i.e.*, measurable by an objective standard "fixed in fact and capable of being stated in definite terms of money" (*Ithaca Trust Co.* v. *United States*, 279 U.S. 151, 154; *Merchants Bank* v. *Commissioner*, 320 U.S. 256; *Henslee* v. *Union Planters Bank*, 335 U.S. 595); and (2) viewing the circumstances as of the date of death of the decedent, "the possibility that the charitable transfer will not become effective is so remote as to be negligible" (Regulations Section 20.2055-2(b)), *i.e.*, there must be "assurance that charity will receive the bequest or some determinable part of it" (*Commissioner* v.

Sternberger's Estate, 348 U.S. 187, 199; *Humes* v. *United States*, 276 U.S. 487).

Applying the rationale of the above decisions, the court below correctly held that the comprehensive discretionary powers conferred by the decedent upon her trustee to allocate trust principal to income, construed in accordance with the New York law relating to the duties imposed upon a fiduciary, prevented the value of the charitable remainders in question from being "presently ascertainable" as of the date of the decedent's death, and hence from qualifying for deduction under Code Section 2055 (prior to its amendment by the Tax Reform Act of 1969) and the then applicable Treasury Regulations. The decision below is in accord not only with this Court's decisions in cases involving the deductibility of charitable remainders subject to direct invasionary power, but with other decisions in cases involving substantially the same issue here presented—deductibility of a charitable remainder subject to indirect invasion by exercise of the trustee's power of allocation between principal and income. *Florida National Bank at Lakeland* v. *United States*, 443 F. 2d 467 (C.A. 5); *Miami Beach First National Bank* v. *United States*, 443 F. 2d 475 (C.A. 5); *First National Bank in Palm Beach* v. *United States*, 443 F. 2d 480 (C.A. 5); and *Rand* v. *United States*, 28 A.F.T.R. 2d, ¶ 147,602 (C.A. 2).[1] See also *Greer* v. *United States*, 25

[1] The Third Circuit, which decided the instant case, also decided *Peoples Trust Co. of Bergen County* v. *United States*, 27 A.F.T.R. 2d, ¶ 147,582, in favor of the taxpayer. That case involves New Jersey rather than New York law,

A.F.T.R. 2d 70-1629 (D. N.C.), appeals pending C.A. 4, Nos. 15,425, 15,426; and *Gardiner* v. *United States*, 24 A.F.T.R. 2d 69-6108 (D. Ariz.), appeal pending C.A. 9, No. 24,760.

Petitioner attacks the decision below on two grounds: (a) that the court of appeals misapplied the relevant principles of federal law concerning the "presently ascertainable" requirement (Pet. 7-13); and (b) that the court misinterpreted the restrictions imposed upon fiduciaries by New York law (Pet. 13-18).[2] Neither contention has merit.

(a) The Treasury Regulations on Estate Tax (Section 20.2055-2) have long provided that an estate tax deduction will be allowed for the present value of a charitable remainder interest preceded by a noncharitable life interest only if the remainder interest is "presently ascertainable, and hence severable from the noncharitable interest"; and that if the remainder is subject to a power to divert corpus to the noncharitable life beneficiary, the deduction is allowable only to the extent that corpus is "exempt from an exercise of the power."

Ithaca Trust Co. v. *United States*, *supra*, 279 U.S. at 154, involved a bequest of a charitable remainder

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and the opinion explains that it does not conflict with the opinion in the instant case. Even if the decisions of the Third Circuit were not in harmony with each other, the intra-circuit conflict (with respect to the laws of different states) would not furnish a basis for review by this Court. *Wisniewski* v. *United States*, 353 U.S. 901.

[2] The brief of the *amici curiae* in support of the petition advances essentially the same arguments.

interest preceded by a life estate in decedent's wife, with instructions to the trustee to invade principal in favor of the wife in such amounts "that may be necessary to suitably maintain her in as much comfort as she now enjoys." The Court held *(ibid.)* that this was a standard of invasion "fixed in fact and capable of being stated in definite terms of money," and accordingly allowed the charitable deduction; the possibility that the trust income might fall below the wife's living expenses was not "appreciably greater than the general uncertainty that attends human affairs" and could therefore be disregarded.

Merchants Bank v. *Commissioner, supra,* involved a power of invasion for the "comfort, support, maintenance, and/or happiness" of decedent's wife. Distinguishing *Ithaca Trust,* the Court held that this standard of invasion was too broad for allowance of a deduction for the charitable remainder despite the fact that Massachusetts law might restrict the discretion of the trustee more narrowly than a literal reading of the will would suggest. The Court stated (320 U.S. at 261) that: "Only where the conditions on which the extent of invasion of the corpus depends are fixed by reference to some readily ascertainable and reliably predictable facts do the amount which will be diverted from the charity and the present value of the bequest become adequately measurable."

Finally, in *Henslee* v. *Union Planters Bank, supra,* the decedent bequeathed an annuity to his mother, with instructions to invade corpus for her "pleasure, comfort and welfare," the remainder to go to charity. Again distinguishing *Ithaca Trust* and following its

Merchants Bank reasoning, the Court held this standard to be so indefinite as to preclude the charitable remainder from being presently ascertainable. In response to the executor's argument that the trustees were limited in the exercise of their invasionary power by their fiduciary responsibilities to the remaindermen, the Court noted (335 U.S. at 598-599 n.3) that "respondents' fiduciary duty to the ultimate beneficiaries, private and charitable, was ineffective to guarantee preservation of any predictable fraction of the corpus for disposition after the mother's death."

The court below properly applied the rationale of the above decisions to the instant case. The trustee here was granted the power, in its "sole and absolute discretion," to invest trust corpus and apportion trust income in such a manner as to effect substantial diminution of corpus through accelerated payout of income. For example, wasting assets could be purchased, with all income derived therefrom allocated to the income beneficiaries; indeed, "any other receipt whatsoever" could be ascribed to income. (Pet. App. 6). As the court below observed (Pet. App. 12), the resulting effect on trust corpus "is similar to the possibilities in direct invasion cases."

There is no warrant for petitioner's contention (Pet. 8-10) that this case is analogous to *Ithaca Trust*. In *Merchants Bank* and *Union Planters*, this Court made it clear that its prior decision in *Ithaca Trust* was to be confined to situations where the trustee's invasionary power was tied to a readily measurable standard existing at the time of the dece-

dent's death, such as the past support of the life beneficiary. No such situation is here presented. Here, as in *Merchants Bank* (320 U.S. at 261-262), the "extent to which the principal might be used was not restricted by a fixed standard," and hence did not lend itself to "reliable prediction." See also *Union Planters*, 335 U.S. at 599. Nor has petitioner cited any authority or offered a persuasive rationale for its asserted distinction (Pet. 10-11) between "direct" powers of invasion and "indirect" powers based upon the grant of broad administrative discretion. In either case, the possibility of diversion of trust principal is present. In fact, where as here the trustee has unfettered discretion to allocate between principal and income, this possibility may be even greater since the trustee is not limited to a specified purpose for which he may invade corpus for the benefit of the income beneficiary.[3]

(b) As for petitioner's second argument (Pet. 13-18)—that the court below erroneously interpreted

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[3] *Amici* mistakenly assert (Br. 4-8) that the Commissioner's position in this and related cases stems from a "changed interpretation of the law" first announced in Rev. Rul. 60-385, 1960-2 Cum. Bull. 77. That ruling was concerned only with the effect of a power to allocate capital gains distributions of regulated investment companies to an income beneficiary—only one of the many possible administrative powers which may alter the dividing line between a charitable remainder interest and a noncharitable life estate. The decedent here had long been put on notice that the existence of broad administrative discretion in the trustee might render an otherwise deductible charitable interest unascertainable for federal tax purposes. See, *e.g.*, *Colt* v. *Duggan*, 25 F. Supp. 268 (S.D. N.Y.); *State Street Trust Co.* v. *United States*, 263 F. 2d 635 (C.A. 1).

New York law—petitioner cites no authority to support the view that despite the absolute discretion granted to the trustee by the trust instrument, New York law imposes a standard of conduct upon the trustee so exacting as to satisfy the strict requirements of the "presently ascertainable" test. Indeed, New York courts have repeatedly held that powers similar to those conferred on the trustee in the instant case vest in him the broadest of discretion to contravene the rules of allocation normally imposed by law, even though his action may reduce the interest of either the life beneficiary or the remainderman; and that a court of equity will not question the trustee's exercise of discretion if it appears from the trust instrument that the settlor intended that allocation questions be resolved conclusively by the trustee rather than through litigation.[4] Clearly, under New York law the discretionary powers conferred by decedent upon her trustee were effective to allow at least some depletion of corpus below the date-of-death value. This uncertainty in and of itself suffices to prevent the remainder interest which would even-

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[4] See *e.g.*, *In re Estate of Davis*, 54 Misc. 2d 1065, 284 N.Y.S. 2d 414 (Surr. Ct.); *In re Morron's Estate*, 10 Misc. 2d 861, 169 N.Y.S. 2d 783 (Surr. Ct.); *In re Harmon's Trust*, 5 Misc. 2d 308, 164 N.Y.S. 2d 468 (Sup. Ct.); *In re Liebmann's Trust*, 131 N.Y.S. 2d 144 (Sup. Ct.); *Chase National Bank* v. *Chicago Title & Trust Co.*, 246 App. Div. 201, 284 N.Y.S. 472, affirmed, 271 N.Y. 602, 659, 3 N.E. 2d 205; *In re Grover's Estate*, 24 Misc. 2d 857, 205 N.Y.S. 2d 537 (Surr. Ct.); *In re Sampson's Estate*, 193 Misc. 166, 83 N.Y.S. 2d 200 (Surr. Ct.); *In re Bruen's Estate*, 83 N.Y.S. 2d 197 (Surr. Ct.).

tually pass to charity, from being "fixed in fact and capable of being stated in definite terms of money." *Merchants Bank* v. *Commissioner*, *supra*, 320 U.S. at 263.

2. The decision below does not, as petitioner asserts (Pet. 19-24), conflict with that of the First Circuit in *Old Colony Trust Co.* v. *United States*, 423 F. 2d 601. The court there held that a decedent who had retained the power as trustee to pay out corpus to the life beneficiary of an inter vivos trust, if he deemed it in the beneficiary's "best interest," retained dominion and control over the trust property tantamount to ownership, and that therefore the value of the trust property was includible in his estate. By way of dictum, the court rejected the government's alternative contention that the presence of broad administrative powers in the trustee required the same result. It first noted that since its earlier decision in *State Street Trust Co.* v. *United States*, 263 F. 2d 635, the Supreme Judicial Court of Massachusetts had overruled prior law as expressed in *Dumaine* v. *Dumaine*, 301 Mass. 214, 16 N.E. 2d 625, and had held in *Old Colony Trust Co.* v. *Silliman*, 352 Mass. 6, 223 N.E. 2d 504, that a power to allocate trust receipts and expenses between income and principal permitted an exercise of discretion only in doubtful cases not covered by state law. Given this interpretation by the highest state court, the First Circuit stated that under Massachusetts law no aggregation of administrative powers could meet the test of "sufficient dominion and control so as to be equated with ownership" under Sections 2036 and

2038. The case at bar, of course, deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038.

3. The importance of the question presented has been diminished by the recent amendments to Section 2055 enacted in the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, 560. For charitable remainder trusts of decedents dying after December 31, 1969,[5] a deduction is allowable for a charitable remainder interest only if the trust qualifies as an "annuity trust" (under which the income beneficiary is to receive a stated dollar amount annually), or a "unitrust" (under which the income beneficiary is to receive an annual payment based on a fixed percentage of the net fair market value of the trust assets). Section 201(d), (e), and (g) of the Tax Reform Act of 1969. See S. Rep. No. 91-552, 91st Cong., 1st Sess., p. 87.

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[5] Except irrevocable trusts established before October 9, 1969, or revocable trusts of settlors who die before October 9, 1972, if the trusts were written on or before October 9, 1969.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEPTEMBER 1971.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1971 442643 152

No. 70-236

IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

ESTATE OF LILLIE MACMUNN STEWART, Deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF FOR *AMICI CURIAE*

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REPLY BRIEF FOR *AMICI CURIAE*

Statement

This Brief is submitted by the *Amici Curiae,* The New York State Bankers Association (Trust Division) and The Corporate Fiduciaries Association of New York City, in reply to the Brief for the Respondent in Opposition. Petitioner concurs fully in the views expressed herein.

Summary of Argument

All three of Respondent's legal arguments are destroyed by its own arguments in its Brief and in its Petition for Rehearing in the *Peoples Trust Co.* case (set forth in Pet. Supp. 13a-21a).

1. The government's Petition for Rehearing in *Peoples Trust Co.* destroys its Point 1, by conceding that state law differences are not legally significant to the proper application of section 2055, the laws of the various states being all based on the same equitable principles.

2. Respondent's citation of *State Street Trust Co.* v. *United States,* a case dealing with Massachusetts law and the inclusion of a trust corpus in a decedent's gross estate under sections 2036 and 2038, destroys its argument in Point 2, that *Old Colony Trust Co.* v. *United States* is not in conflict with the case at bar, because the case at bar "deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038." [1]

3. Respondent's citation of *Colt* v. *Duggan* destroys its Point 3, that the issue herein "has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969." Under *Colt* v. *Duggan* and the government's interpretation of the case at bar as revealed in its Petition for Rehearing in *Peoples Trust Co.*, no pre-Tax Reform Act charitable remainder trust would be entitled to an income tax charitable deduction in any future year for capital gains "permanently set aside for charity". Such trusts are numbered in the thousands.

4. The government's silences speak as eloquently as its admissions. It does not deny: (i) that the additional discretions given the trustee by Mrs. Stewart did not materially increase the trustee's power to shift economic inter-

[1] A second direct conflict with the decision in the case at bar has just been created by the Fourth Circuit's affirmance on September 1, 1971 of *Greer* v. *United States.* Petitioner will file a Second Supplemental Brief, appending the Fourth Circuit's opinion thereto.

ests between income beneficiary and remaindermen; (ii) that the valuation tables prescribed by the Commissioner are valid only on the assumption that all trustees' discretions will be impartially exercised; (iii) that there is no reason to believe that the discretions given the trustee in the case at bar will not be exercised impartially; (iv) that the chance that the charitable remaindermen will not receive the gift Mrs. Stewart intended is so remote as to be negligible; and (v) that the government's position, as set forth in its *Peoples Trust Co.* Petition for Rehearing, would result in the denial of income, gift and estate tax charitable deductions for all charitable remainders following income interests in trust, though settled law is to the contrary. In stating that there is "no conflict" and that the question presented is "moot", Respondent also conveniently omits reference to the more than 48 docketed cases involving this issue.

5. The question presented here has never been decided by this Court. In order to put an end to existing widespread controversy, and prevent extensive future burdensome litigation from clogging the federal courts, petitioner has shown overwhelmingly the need for this Court to grant the Petition for Certiorari and to correct the decision below.

Argument

1. Without being told, no one would believe that the government's Brief for the Respondent in Opposition and its Petition for Rehearing in the *Peoples Trust Co.* case (Pet. Supp. 13a-21a), were filed by the same party. Reasoning from the premise that the decision below is correct, Respondent in *Peoples Trust Co.* was all for "clarity and consistency in this area of the tax law" (Pet. Supp. 14a). Respondent submitted "that if New York's fiduciary law did not limit the *Stewart* trustee's

invasionary powers so as to satisfy the requirements of Section 2055, New Jersey law must equally be insufficient to satisfy the requirements of that section. The laws of these two states are based upon essentially the same equitable principles." (Pet. Supp. 19a-20a). And it concluded, "The mere fact that the two trustees may be held accountable to courts of different states, provides no adequate basis for the difference in outcome when these courts apply the same standards to review exercises of discretionary powers." (Pet. Supp. 21a).

In this Court, however, where the correctness of the decision below is hotly disputed, one hears nothing whatever from the government about the desirability of "clarity and consistency." Its efforts are directed to pointing out differences in the cases rather than discovering the underlying principles of law common to them. Not integration, but differentiation is the government's purpose here. So, writes Respondent, "the decision [below] turns largely upon a proper construction of state (here New York) law governing the administrative powers of a fiduciary." (Resp. 5). "That case [*Peoples Trust Co.*] involves New Jersey rather than New York law, and the opinion explains that it does not conflict with the opinion in the instant case." (Resp. 6-7, n. 1). So again, Respondent writes that Revenue Ruling 60-385 1960-2 Cum. Bull. 77 (and, of necessity, Revenue Ruling 55-620, 1955-2 Cum. Bull. 56, which was in force when Mrs. Stewart acted and which Revenue Ruling 60-385 overruled) "was concerned only with the effect of a power to allocate capital gains distributions of regulated investment companies to an income beneficiary—only one of the many possible administrative powers which may alter the dividing line between a charitable remainder interest and a noncharitable life estate." (Resp. 10, n. 3). And "of course," writes Respondent, the decision below does not conflict with *Old Colony Trust Co.*

v. *United States*, 423 F. 2d 601, 70-1, U. S. Tax Para. 12,667, 25 Am. Fed. Tax R. 2d 70-1549 (1st Cir. 1970) because the case at bar "deals neither with Massachusetts law nor with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038." (Resp. 13).

The Petition for Rehearing in *Peoples Trust Co.* shows that the government has no difficulty whatever in perceiving and utilizing the common legal principles in these cases when it believes its purposes are served thereby. It exposes completely the pretense of the government's Point 1 (Resp. 5-12), that state law differences are material. The laws of the states are founded on the same equitable principles, and the fiduciary duties imposed on trustees are essentially the same everywhere.

2. Respondent's Brief in Opposition exposes the falsity of its Point 2 (Resp. 12-13), that the instant case and the *Old Colony Trust Co.* case are not in conflict.

Clearly stung deeply by our reproach that this case involves a retroactive application of a changed interpretation of the law by the Internal Revenue Service (*Am. Cur.* 5, n. 3) Respondent offers the following justification: "The decedent here had long been put on notice that the existence of broad administrative discretion in the trustee might render an otherwise deductible charitable interest unascertainable for federal tax purposes. See, *e.g., Colt* v. *Duggan*, 25 F. Supp. 268 (S.D.N.Y.); *State Street Trust Co.* v. *United States*, 263 F.2d 635 (C.A. 1.)" (Resp. 10, n. 3).

But *State Street Trust Co.* was not a charitable deduction case. It deals "with Massachusetts law" and "with inclusion of a trust corpus in a decedent's gross estate under Sections 2036 or 2038," [2] the very two circumstances

[2] Actually, sections 811(c) and 811(d) of the 1939 Code, which became sections 2036 and 2038 of the 1954 Code.

the government claims prevent *Old Colony* from conflicting with the case at bar (Resp. 13). If decisions under sections 2036 and 2038 involving Massachusetts law were relevant to the deductibility of Mrs. Stewart's gift in 1960, when she made it, they are relevant now.[3] The government's own words show its Point 2 is untenable. The conflict does exist, as the petition alleges (Pet. 19-24).

---

[3] Respondent's statement (Resp. 12), that the Massachusetts court had "overruled prior law" between the times *State Street Trust Co.* and *Old Colony Trust Co.* which specifically overruled it, were decided, is incorrect. The First Circuit in *Old Colony* expressly stated that the Massachusetts court *"has twice criticized State Street for its seeming departure* [from Massachusetts law]" (423 F. 2d at 603) (emphasis supplied), and the Massachusetts court itself in *Worcester County National Bank* v. *King*, —— Mass. ——, 268 N.E. 2d 838 (1971) has made it crystal clear that Massachusets law on this point has been the same right along:

> "We trust that this opinion will serve to dissolve any remaining doubts concerning that supervision which Massachusetts courts sitting in equity will exercise over trusts containing broadly phrased clauses relative to trustees' administrative or management powers. Doubt in this area of the law was caused by the decision of the United States Court of Appeals, First Circuit, in *State Street Trust* v. *United States*, 263 F.2d 635, relying on broad language in *Dumaine* v. *Dumaine*, 301 Mass. 214, 16 N.E. 2d 625, a case which dealt with a fact situation far removed from this one. *In the intervening years we took occasion, most notably in the Silliman case, to dispel the misunderstanding engendered by the Dumaine case as interpreted by the State Street Trust Co. case.* [cites omitted] The First Circuit itself has recently reversed the view it took of Massachusetts law in *State Street Trust Co.* v. *United States, supra*, (*Old Colony Trust Co.* v. *United States*, 1 Cir., 423 F. 2d 601, 602-603)." (268 N.E. 2d at 841) (emphasis supplied).

State Street, like *Colt* v. *Duggan*, erroneously interpreted existing state law by failing to give full effect to the identical state law principle—the trustee's duty to exercise all his discretionary powers, both investment and administrative, impartially for the benefit of all beneficiaries—that is at the heart of this case. Respondent incorrectly suggests that *Old Colony* is not inconsistent with *State Street* (Resp. 12). *State Street* was "effectively overruled" by *Old Colony* (*Greer* v. *United States, supra*, n. 1).

3. By citing *Colt* v. *Dugan, supra,* the government refutes its own statement, elaborated on in its Point 3, that "the issue presented has been rendered moot for the future by amendments to Section 2055 of the Internal Revenue Code of 1954 enacted by the Tax Reform Act of 1969." (Resp. 5). Citation of this case shows that the government agrees with the statements in Petitioner's Supplemental Brief (at p. 8) and the Brief for *Amici Curiae* (at p. 13), that the issue herein affects the income tax liability of every charitable remainder income trust for all open and future years in which capital gains are realized. The specific question in *Colt* v. *Duggan* was whether capital gains realized by the trustee could be said to be "permanently set aside" for charitable purposes, and hence whether they were deductible under section 162 of the Revenue Act of 1932, the predecessor of present section 642(c)(2), in view of the trustee's broad administrative powers.[4] The issue herein is hardly "moot" and passage of the Tax Reform Act obviously did little to diminish the importance of the question in this case.

The government's tough position is ludicrous that Mrs. Stewart should have reasoned from a long discredited section 642(c)(2) case, and an always controversial and subsequently overruled section 2036 case, rather than from a 1955 Service ruling dealing directly with sections 170, 2055 and 2522, the income, estate and gift tax charitable deduction sections that Mrs. Stewart was trying to comply with. It simply emphasizes the injustice done Mrs. Stewart and other taxpayers similarly situated by the government's fail-

[4] In an exact foreshadowing of the downfall of *State Street Trust Co.* v. *United States* three decades later, *Colt* v. *Duggan,* which was decided on September 16, 1938, came to its end as a viable legal precedent on February 9, 1939, when the New York court construing the identical trust decided that the trustee had no right under New York law to do the things the federal district court had said he could. *Matter of Talbot,* 170 Misc. 138, 9 N.Y.S. 2d 806 (Sur. Ct. Orange Co. 1939).

ure to recognize that it had any obligation to guide taxpayers in this obviously difficult area of the tax law. Our statement bears repeating that "Many wills and trust agreements prepared in all good faith that became effective, or will become effective, between January 1, 1961 and October 9, 1972 and are now or will be in litigation would have been rewritten to conform to the changed rules if the draftsmen had only known new rules were in effect and what they were." (*Am. Cur.* 5, n. 3). Taxpayers like Mrs. Stewart are not tax dodgers to be dealt with so insensitively. All they wish to accomplish when making trusts of this kind is to discharge their primary obligations to themselves and their families and then give what is left to charity. They deserve better treatment at the hands of the government than this.

4. Respondent makes no effort to deny that the additional discretions given the trustee by Mrs. Stewart did not materially increase the trustee's power to shift economic interests between income beneficiary and remainderman (*Am. Cur.* 14-16); or that the valuation tables prescribed by the Commissioner are valid only on the assumption that all trustees' discretions will be impartially exercised (*Am. Cur.* 17-18); or that there is no reason to believe that the discretions given the trustee in the case at bar will not be exercised impartially (*Am. Cur.* 18-24); or that the chance that the charitable remaindermen will not receive the gift Mrs. Stewart intended is so remote as to be negligible (*Am. Cur.* 24-25); or that Respondent's position, set forth in its *Peoples Trust Co.* Petition for Rehearing, would result in the denial of income, gift and estate tax charitable deductions for all charitable remainders following income interests in trust, through settled law is to the contrary (Pet. Supp. 5-10). In stating that there is "no conflict" and that the question presented is "moot", Respondent also con-

veniently omits reference to the more than 48 docketed cases involving this issue listed in Respondent's Chief Counsel's Office (Pet. Supp. 10-11, 22a-23a.)

5. Respondent is less than candid in suggesting that prior decisions of the Supreme Court have settled the merits of the issue presented in this case (Resp. 5). While the merits are secondary to the primary issue presented by this Petition—the need to bring order out of the chaotic state of the law and to resolve the indefensible conflict among the circuits[5]—it is important not to be misled by Respondent's suggestion that the merits have already been decided by this Court. The prior decisions of this Court cited by Respondent (Resp. 5, 7-10) involved trust instruments which evidenced an affirmative intention on the part of the creator of the trust that principal should be invaded for the benefit of non-charitable beneficiaries, as expressed in the dispositive provisions of those instruments. What is new in this case is the government's fastening upon routine administrative provisions dealing with allocation of receipts and disbursements between principal and income which are invariably inserted in trust instruments by experienced draftsmen for the purpose of facilitating the orderly administration of the trust. This Court has not decided any case holding or implying that routine administrative provisions in trust instruments should determine their tax consequences.

By every standard—the significance of the legal issue, the confusion in the cases and conflict in the circuits, the number of taxpayers affected, the amount of revenue involved, the justice of taxpayer's case, and most important of all, the need to put an end to existing widespread con-

[5] The conflict continues to escalate. *Greer* v. *United States* (*Am. Cur.* 10) was affirmed by the Court of Appeals for the Fourth Circuit in favor of the taxpayer on September 1, 1971. (See n. 1).

troversy and stem the tide of litigation in the already heavily burdened federal courts[6]—Petitioner has shown overwhelmingly the need for this Court's granting the Petition for Certiorari and correcting the decision below.

CONCLUSION

Respondent has presented no convincing argument for denial of a Writ of Certiorari, and the Petition should be granted.

Respectfully submitted,

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[6] Already the tide of litigation is lapping at this Court's feet. Petitions for Certiorari to the Fifth Circuit were filed on July 7, 1971 in the *First National Bank in Palm Beach* case, and on September 3, 1971 in the *Miami Beach First National Bank* case (Pet. 10, Pet. Supp. 3).

SUPREME COURT, U. S.
In The

Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-236

ESTATE OF LILLIE Mac MUNN STEWART, deceased,
W. ALAN HENDERSON, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITIONER'S SECOND SUPPLEMENTAL BRIEF

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Law and Financial Printing
South River, N.J. (201) 257-6850
New York, N.Y. (212) 565-6377
Philadelphia, Pa. (215) 563-5587

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In The

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W. ALAN HENDERSON, Executor,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITIONER'S SECOND SUPPLEMENTAL APPENDIX

Statement

This Second Supplemental Brief is submitted to bring to the attention of this Court developments since the filing of the Petition and Supplemental Brief by the petitioner and particularly the decision of the United States Court of Appeals for the Fourth Circuit in the case Greer v. United States (Appendix A, 1a) decided September 1, 1971. The Amici Curiae, the New York State Bankers Association (Trust Division) and the

Corporate Fiduciaries Association of New York City, concur fully in the views expressed herein.

Summary of Argument

On September 1, 1971 the United States Court of Appeals for the Fourth Circuit decided the case, Greer v. United States, in a way that is clearly and directly in conflict with the holding of the United States Court of Appeals for the Third Circuit in the case at bar, and with the two decisions of the United States Court of Appeals for the Fifth Circuit.[1] The Circuit Courts are diametrically opposed in their final determination of the basic issue as presented by this case. Unless resolved by this Court the conflict created by the Circuit Court cases has and will continue to result in confusion and uncertainty as to the proper application of established guide lines, not only relative to the Federal Tax laws but indeed throughout the spectrum of our trust and fiduciary law.

---

1. The opinion of the Fourth Circuit Court of Appeals in the Greer case also squarely conflicts with the decisions of the Court of Appeals for the Fifth Circuit in Miami Beach First National Bank v. United States, ___ F.2d ___, 71-1 U.S. Tax Cas. Para. 12,774,27 Am. Fed. Tax R.2d Para. 147,565 (5th Cir., April 26, 1971) and First National Bank in Palm Beach v. United States, ___ F.2d ___, 71-1 U.S. Tax Cas. Para. 12,777,27 Am. Fed. Tax R.2d Para. 147,570 (5th Cir., May 7, 1971), which cases generally follow the reasoning espoused in the case at bar. See Point I, Petitioner's Supplemental Brief, p. 3 and brief of Amici Curiae p. 10, 20.

Argument

I.

THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT IN GREER v. UNITED STATES IS DIRECTLY AND UNMISTAKABLY IN CONFLICT WITH THE DECISION OF THE COURT OF APPEALS FOR THE THIRD CIRCUIT IN THE CASE AT BAR.

On September 1, 1971 the United States Court of Appeals for the Fourth Circuit decided the case entitled Hattie S. C'Briant Greer, Executrix of the Estate of William S. O'Briant, deceased, v. United States of America, 70-1 U.S. Tax cases, para. 12,690, 25 Am. Fed. Tax 2d 70-1629 (M.D. N.C. 1970), affirmed ___ F.2d ___ (4th Cir. Sept. 1, 1971) the pertinent portions of which decision is appended hereto (Appendix A, 1a). The proceedings before the Court of Appeals for the Fourth Circuit in that case involved both an appeal by the Executrix on a question of land title and its applicability to the marital deduction provisions of 26 U.S.C.A. Sec. 2056 with which we are not here concerned, and a cross appeal by the government directly raising the question whether the value of the charitable remainder of a trust was "presently ascertainable" so as to entitle the estate to a charitable deduction in the computation of the estate taxes.

It is the latter issue as decided by that Court which is so germane to the issue here at bar. In the Greer v. United States case, the Court of Appeals for the Fourth Circuit was faced with a

set of facts growing out of the language of a trust instrument very similar to the trust instruments in the case at bar insofar as the administrative powers of the trustee are concerned. The trust instruments in both cases provided for income to be paid for life and upon the life beneficiary's death the remainder to be distributed to charitable organizations within the meaning of Section 2055 of the Internal Revenue Code of 1954. The trust instrument in the Greer case contained an additional provision providing that the trustee should invade the principal to permit the surviving life beneficiary to maintain the standard of living in existence at the time of the creation of the trust. This provision however was not considered controlling by either the Court or the government.

The Court in the Greer case recognized the government's early reliance on the decision in State Street Trust Company v. United States, 263 Fed. 2d 635 (1 Cir. 1959) but discounted the applicability of the reasoning of that case in determining, as the petitioner has consistently argued, that the State Street case had been effectively overruled and repudiated by the Court of Appeals for the First Circuit in Old Colony Trust Company v. United States, 423 Fed. 2d 601 (1 Cir. 1970). This determination is in direct conflict with the holding of the Court of Appeals for the Third Circuit in this case which reasoned that the Court of Appeals for the First Circuit had merely qualified its previous decision in the State Street case and had not repudiated the general tenor of the doctrine established by that case, holding that the mere recitation of the administrative powers were suf-

ficient to override the applicability of the long and well established doctrines relative to the duty and the obligation of the trustees and fiduciaries to be fair and just to all parties and interests they serve.

This seed of conflict through a further analysis of the two cases grows into a tree of thorns whose resulting branches are confusion and uncertainty. For the crucial and overriding conflicts that persist as a result of the Greer case and the case at bar fall within two critical and important areas of our law, transcending beyond their applicability to an important question of federal tax law and materially affecting basic concepts of our trust and fiduciary law.

First the Courts are squarely opposed as to the applicability of the long established doctrine that equity and the laws of all of our states require that a trustee in the performance of its duty act fairly and justly in relation to all of the parties and interests which the trustee serves. The Fourth Circuit Court determined that the law of North Carolina recognizes the rule that a trustee must deal impartially with the beneficiaries of a trust and that this rule, in effect, created the necessary standard upon which "present" ascertainability, could be based. It is interesting to note that the Court of Appeals for the Fourth Circuit in the Greer case cites as authority for this premise, Bankers Trust Co. v. United States, 308 F. Supp. 545 (S.D.N.Y. 1970), aff'd on other grounds 438 Fed. 2d 1046 (2d Cir. 1971), the very case that petitioner here has relied upon in arguing that the laws of New York also hold that the

general administrative powers held by a trustee are subject to a fiduciary responsibility and duty to be exercised impartially as between the life and remainder beneficiaries. Here again the Court of Appeals for the Third Circuit in the case at bar differed with the Court in the Greer case as to the applicability of the determination in the Bankers Trust Co. case.

Secondly, the United States Court of Appeals for the Fourth Circuit in the Greer case followed the long established precept of our law prevalent in all jurisdictions that the intention of the settlor as expressed by the instrument is of tantamount importance in arriving at a decision as to the applicability of the Federal Tax laws. That Court, unlike the Court of Appeals for the Third Circuit recognized that the intention of the settlor is reflected in the dispositive provisions of the trust instrument and that there is a clear distinction between such dispositive provisions and the administrative provisions wherein trustee is given certain expressed power for the purpose of permitting it to operate effectively. The Court of Appeals in the Greer case was pragmatic in its approach while the Third Circuit in failing to clearly distinguish between the administrative and dispositive provisions of the trust instrument erred, and the result of its decision in this case is to make of prominent importance, not the intention of the settlor, but rather the technical administrative language of the scrivener. The rationale of such a determination will permeate the very foundation of our long established trust law, and will eventually tend to weaken the edifice of trustee responsibility.

II.

THE CONFLICT CREATED BY THE DECISIONS OF THE CIRCUIT COURT OF APPEALS IN THESE CASES CANNOT BE RESOLVED BY A MERE DETERMINATION THAT THE LAWS OF THE RESPECTIVE STATE JURISDICTIONS AS THEY RELATE TO THE MAIN ISSUE OF THESE CASES ARE ESSENTIALLY DIFFERENT.

The government's apparent argument in opposition to the granting of the Writ of Certiorari in this case is that while admittedly the various Circuit Courts of Appeal have come to different conclusions on the same set of facts, they have done solely through an interpretation of state laws which they have found to be quite different.

The entire tenor of petitioner's argument throughout the case at bar has been that this is simply not so. If we accept the premise that a sufficient standard for determining "present ascertainability" is properly founded on the duty and obligation of a trustee to act impartially and in fairness to all of the parties of a given trust as adopted by the Court of Appeals for the Fourth Circuit and indeed by the Court of Appeals for the Third Circuit itself[2] we are led to the inescapable conclusion that the decision below in this case was erroneously conceived.

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2. Peoples Trust Co. of Bergen County v. United States, ___ F.2d ___, 71-1 U.S. Tax Cas. Para. 12,786, 27 Am. Fed. Tax R.2d Para. 147,582 (3d Cir. 1971). See discussion Amici, reply brief, pp. 3-6.

It is to this issue which we here seek permission to argue in order that this Court can establish clear and definitive guide lines for the determination as to those elements necessary to support "present ascertainability" under the applicable Federal Tax law. This we submit is of paramount importance to the fair treatment of all of our citizens under the Federal Tax laws and throughout the entire sprectrum of trust and fiduciary law.

Conclusion

For the foregoing reasons, and for the reasons previously expressed on behalf of the petitioner, the Petition for the Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A

Opinion

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 15,425

Hattie S. O'Briant Greer, Executrix of the Estate of William S. O'Briant, deceased,

Appellee,

versus

United States of America,

Appellant.

No. 15,426

Hattie S. O'Briant Greer, Executrix of the Estate of William S. O'Briant, deceased,

Appellant,

versus

United States of America,

Appellee.

Appendix A - Opinion

Appeals from the United States District Court for the Middle District of North Carolina, at Greensboro.
Edwin M. Stanley, Chief Judge.

(Argued May 13, 1971 Decided September 1, 1971)

WINTER, Circuit Judge:

The appeal of plaintiff (No. 15,426), the executrix of her deceased husband's estate, in her suit for refund of estate taxes, raises the question of whether the deceased's interest in a farm, the record title of which was solely in his name, passed to his wife so as to entitle the estate to a marital deduction under 26 U.S.C.A. § 2056. It is the plaintiff's position that notwithstanding record title she and her deceased husband owned the farm as tenants by the entireties so that the deceased's interest passed to her by operation of law. The government's appeal (No. 15,425) raises the question of whether the value of the charitable remainder of the trust of the husband's residuary estate is "presently ascertainable" so as to entitle the estate to a charitable deduction in the computation of estate taxes. The government's position is that the discretionary power of the trustees to reinvest the principal of the trust estate and to allocate and apportion receipts and expenses between principal and income rendered the ascertain-

ment of present value impossible so as to require disallowance of the charitable deduction.

The District Court made detailed findings of fact, and, without discussion or citation of supporting authorities, concluded that the farm was owned by the husband alone — thus disqualifying it, under this particular will, for the marital deduction — and that the possibility that the charitable transfer will not become effective was so remote as to be negligible — thus allowing the charitable deduction. We disagree in part with respect to the farm, but we agree with respect to deductibility of the value of the charitable remainder. We, therefore, affirm in part and reverse in part.

Since the two questions involve largely unrelated facts and legal issues, we will treat them in separate sections of this opinion.

-I-

The Claimed Marital Deduction

A.

(We omit herewith that part of the opinion dealing with the marital deduction claim inasmuch as it is not pertinent to the issue herein presented.)

* * *

-II-

Deductibility of the Charitable Remainder

Appendix A - Opinion

A.

On January 11, 1957, plaintiff and her husband entered into a trust agreement by which they created an inter vivos trust naming themselves and Planters National Bank and Trust Company, Rocky Mount, North Carolina, as trustees. At the same time, they entered into an agreement to execute separate wills leaving their respective residuary estates to this trust, with the further agreement on the part of plaintiff that in the event her husband predeceased her she would transfer substantially all of her property to the trust at his death. The husband died September 21, 1960, and by his last will and testament he bequeathed his residuary estate to the trust.

Under the trust agreement the settlors retained the right to revoke any gift to the trust during such time as they both should be living. However, upon the death of either all transfers to the trust were to become irrevocable and the retained power to modify, amend or alter the trust agreement to cease. Both before and after the trust became irrevocable, plaintiff and her husband retained the enjoyment of the income of the trust for life, with the further provision that

> The trustees shall pay to or for the benefit of the settlors or the surviving settlor from time to time such sums from principal as will enable them or the survivor to maintain the standard of living to which they, or the survivor, are accustomed at the time of the creation of this trust, taking into

account such other sources of income and capital resources as they or the survivor may have in addition to income from this trust.

The remainder of the estate, upon the death of the surviving spouse, was directed to be paid to the Baptist Children's Home of North Carolina, concededly a charitable organization within the meaning of § 2055 of the Internal Revenue Act of 1954.

It was stipulated that after the husband's death the anticipated costs of maintaining plaintiff according to the standard to which she was accustomed at the time the trust was created amounted to $5,500.00 per year, and that the expected income from the trust as of the date of the husband's death was $13,740.00 per year.

The trust agreement contained numerous provisions relating to the powers of the trustees. We set forth in the margin those on which the government relies for disallowance of the deduction of the value of the charitable remainder. [1] In the exercise of these and the other powers

---

1. ITEM ELEVEN. Powers of Trustees. Without distinguishing between their or their successors' or substitutes' powers as trustees, and by way of illustration and not of limitation and in addition to any inherent or implied or statutory powers they may have now or hereafter acquire in such capacity, we grant the following powers to our trustees and their successors or substitutes. Whenever the singular forms, ("my"; "I", "trustee") is used herein, it is intended to include the plural forms unless the context indicates a contrary intention.

(Continued)

(Continued)

Section 1. Retain original investments. To retain any of the original property in my estate, including any stock we may have in the Planters National Bank and Trust Company or its successor, regardless of the character of such property or whether it shall be such as then will be authorized by law for trust investments or whether it shall leave a disproportionately large part of the trust invested in one type of property, or even in cash uninvested, for such time as to our trustees shall seem best, and to dispose of such property by sale, exchange, or otherwise, as and when it shall deem advisable.

Section 2. Make new investments. To invest and reinvest in stocks (common or preferred), including stock and stock rights in the Planters National Bank and Trust Company or its successor; in bonds, notes, or mortgages on property in or outside the State of North Carolina; in insurance contracts on the life of any beneficiary or of any person in whom a beneficiary has an insurable interest; or annuity contract for any beneficiary; in real property whether or not it is productive at the time of investment; in participations in common trust funds established by the Planters National Bank and Trust Company or its successor; and generally in such property and in such proportions of such property as it shall deem advisable, even though such investment shall not be of the character nor in the proportion approved by applicable law for this provision.

* * *

Section 18. Employ and Compensate. To employ and compensate, out of income or principal or both and in such proportions as to it shall seem proper, agents, accountants, brokers, attorneys at law, attorneys in fact, investment brokers, realtors, tax specialists, and other assistants and advisers deemed by it needful for the proper settlement of my estate and administration of my trusts; and to do so without liability for any neglect, omission, misconduct, or default of such agent or representative provided he was selected and retained with due care on the part of my executor or trustee.

* * *

conferred under the trust agreement, the corporate trustee was required to render its annual account of the receipts, disbursements, and distributions of both principal and income only to the income beneficiaries of the trust.

On the husband's federal estate tax return, plaintiff, as his executor, claimed a charitable deduction of $130,073.19, representing some 60% of the total value of their residuary estate — the actuarial value specified in the Treasury Regulations on Estate Tax for a remainder interest subject to a life estate of a person sixty years old, which was plaintiff's age on the date of her husband's death.

B.

The Internal Revenue Code of 1954 permits the deduction from a decedent's gross estate of the

(Continued)

Section 23. Apportion and allocate receipts and expenses. To determine what is principal and what is income of any trust and to allocate or apportion receipts and expenses as between principal and income in the exercise of its uncontrolled discretion, and, by way of illustration and not limitations of its discretion, to charge premiums on securities purchased at a premium against principal or income or partly against each; to apply stock dividends and other noncash dividends to income or principal or apportion them as it shall deem advisable; to determine what expenses, costs, taxes (other than estate, inheritance, and succession taxes and other governmental legacy charges) shall be charged against principal or income or apportioned between principal and income and in what proportions; to change its plan of allocation or apportionment of receipts and expenses at any time and from time to time as it shall deem advisable, and its allocation or apportionment shall be conclusive. (Emphasis added.)

value of bequests, legacies, devises or other transfers to or for the use of any charitable organization as defined therein. 26 U.S.C.A. § 2055(a). The long-standing provisions of the Treasury Regulations on Estate Tax state that, with respect to testamentary transfers of charitable remainders, the actuariarily computed value of the charitable remainder is deductible "only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest." (Emphasis added.) If the transfer is conditioned on the performance of some act or the happening of some event, the deduction will be allowed only if "the possibility that the charitable interest will not become effective is so remote as to be negligible." 26 C.F.R. §§ 20.2055-2(a) and (b).[2] The additional restrictions on charitable deductions imposed by the Tax Reform Act of 1969, P.L. No. 91-172, 83 Stat. 487, are not involved because that Act was passed after the events at issue here.

In Ithica Trust Co. v. United States, 279 U.S. 151 (1929), the decedent established a testamentary trust for the benefit of his wife for her life, with remainder to charity. The trustee, however, was directed to invade the principal to the extent

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2. The Regulations further provide:

> If the trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. (Emphasis added.) 26 C.F.R. § 20.2055-2(b).

necessary to maintain the wife "in as much comfort as she now enjoys." The Court found that this standard of invasion was "fixed in fact and capable of being stated in definite terms of money," and that the income of the estate was more than enough to support the wife. It, therefore, allowed the deduction, noting that "[t]here was no uncertainty appreciably greater than the general uncertainty that attends human affairs." 279 U.S. at 154. In the instant case, the government concedes that the trustees' power to pay principal to the plaintiff is limited by an ascertainable standard — plaintiff's previous living standard — and hence there is no argument that the deductibility of the charitable remainder is destroyed by the power of invasion.[3] Rather, it is argued that the trust agreement confers such broad administrative powers on the trustees as to permit them indirectly to divert the corpus of the trust to the plaintiff, and that these powers, together with the broad power to make investments, including the purchase of annuity contracts, which favor the income beneficiary at the expense of the remaindermen, have the cumulative effect of rendering not "presently ascertainable" the value of the charitable remainder, and making more than "remote" the possibility that the charitable transfer will never become effective.

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3. In fact, this power to invade corpus is even more limited than in Ithaca Trust, since the trustees must also take into account such sources of income and capital resources as the life income beneficiary may have other than income from the trust.

Perhaps the genesis of the government's argument is the analogous case of State Street Trust Co. v. United States, 263 F.2d 635 (1 Cir. 1959), in which a divided court (Magruder, C.J., dissenting) held that property a decedent had transferred to a trust for the benefit of his children was nevertheless includable in his gross estate under § 811 of the Internal Revenue Code of 1939, which required inclusion of property transferred in contemplation of death where the decedent had "retained ... the right ... to designate the persons who shall possess or enjoy the property," or where "the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or in conjunction with any other person... to alter, amend, revoke, or terminate ...." 26 U.S.C.A. § 811(c) and (d). The deceased was a cotrustee at the time of his death. The court held that discretionary powers conferred by the trust instrument, similar to the ones at issue in the present case, gave so much power to the trustees to affect the rights of the remaindermen and lifeholder that the statutory conditions for exclusion were not satisfied.

But State Street was effectively overruled in Old Colony Trust Co. v. United States, 423 F.2d 601 (1 Cir. 1970), which held that, in the context of broad administrative powers resembling those in the present case, "no aggregation of purely administrative powers can meet the government's amorphous test of 'sufficient dominion and control' so as to be equated with ownership." 423 F.2d at 603. Again, the estate tax problem was not that

of the deductibility of a charitable remainder, but the question of whether the corpora of the trusts were includable in the settlor-trustee's gross estate. The significance of the case is in its recognition that, at least under Massachusetts law, broad management powers, even coupled with insulation for liability for mismanagement, could not relieve a trustee of the duty to administer the estate equitably for the benefit of all interests in the trust and that "trustee powers are [not] to be more broadly construed for tax purposes than the probate court would construe them for administrative purposes." 423 F.2d at 603.

The government has persisted in its advocacy of new repudiated State Street view.[4] And it has gained some converts. Rand v. United States,

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4. As of the time the brief of the United States was filed in this case (May 15, 1971), we were advised that the same question was pending in at least six other cases, viz.,

(1) Gardiner v. United States, 24 A.F.T.R. 2d 6108 (Ariz., May 21, 1969), appeal pending C. A. 9;

(2) Miami Beach First Nat. Bk. v. United States, 25 A.F.T.R. 2d 1502 (S.D. Fla., December 23, 1969), appeal pending C. A. 5;

(3) First Nat. Bk. in Palm Beach v. United States, 25 A.F.T.R. 2d 1588 (S.D. Fla., August 22, 1969), appeal pending C. A. 5;

(4) Peoples Trust Co. of Bergen County v. United States, 311 F. Supp. 1197 (N. J., 1970), appeal pending C. A. 3;

(5) Florida National Bank at Lakeland v. United States, 313 F. Supp. 1072 (M.D. Fla., 1970), appeal pending C. A. 5;

(Continued)

___ F.2d ___ (2 Cir. 1971); Estate of Stewart v. Commissioner, 436 F.2d 1281 (3 Cir. 1971); Miami Beach First National Bank v. United States, ___ F.2d ___ (5 Cir. 1971); First National Bank in Palm Beach v. United States, ___ F.2d ___ (5 Cir. 1971). Cf. Florida Bank at Lakeland v. United States, ___ F.2d ___ (5 Cir. 1971); Van Den Wymelenberg v. United States, 397 F.2d 443 (7 Cir.), cert. den., 393 U.S. 953 (1968). On the other hand, many courts have concluded that general administrative powers held by a trustee are subject to a fiduciary responsibility and duty to be exercised impartially as between the life tenant and remainderman and that, therefore, the deductibility of the charitable remainder is not lost. Bankers Trust Co. v. United States, 308 F.S. 545 (S.D.N.Y. 1970), aff'd on other grounds, 438 F.2d 1046 (2 Cir. 1971); Gardiner v. United States, ___ F.S. ___ (D. Ariz. 1969), appeal pending to the Ninth Circuit. Cf. Peoples Trust Co. v. United States, 311 F.S. 1197 (D. N.J. 1970), appeal pending to the Third Circuit; Estate of Edward E. Ford, 53 T.C. 114 (1969); William T. Grant, 48 T.C. 606 (1967); William D. O'Brien, 46 T.C. 583 (1966).

(Continued)

(3) Rand v. United States, decided November 9, 1970 (Conn.), pending C. A. 2.

The case in the Second Circuit and the three cases in the Fifth Circuit have been subsequently decided in the government's favor, the citations of which are set forth in the text.

None of the authorities sustaining the government's position holds that broad administrative powers always or never prevent the deduction; rather, the cases rely heavily on the trust law doctrines and practices of the particular states involved, as well as the language of the trust instrument under consideration, to determine if there is any real likelihood that the interests of the charitable remainderman can be invaded for the benefit of the life tenant. Thus, in Stewart, supra, the court based its denial of the deduction in part on the conclusion that under New York law the trustee could "shift 'very substantially ... the economic benefit of the trusts between the life tenants and the remaindermen.'" 436 F.2d at 1288. In Rand, supra, where the trustees' powers were unusually broad, the court stated that there was no indication that Vermont law, applicable to the trust at issue, would prevent a "gross depletion of the remainder," for example by investment in wasting assets which would leave "little or no remainder ... for the charities." ___ F.2d at ___. The cases rejecting the government's position have also rested on the trust law doctrines and practices of the particular states involved as well as the language of the trust instrument under consideration although they have evidenced greater liberality in sustaining some flexibility in the administration of the trust without disallowance of the charitable deduction. Thus, we are brought to a consideration of the law of North Carolina with regard to the administration of this trust as the basis of decision of this case.

Appendix A - Opinion

To start with the language of the instrument the government places particular stress on the aggregate of the trustees' powers (a) to invest generally in such property and in such proportions of such property as the trustees shall deem advisable, even though such investment shall not be of the character nor in the proportion approved by applicable law, (b) to invest in an annuity contract for the benefit of the widow, and (c) to allocate and apportion expenses and receipts to principal and income in their "uncontrolled discretion," with the further protection that the trustees' "allocation or apportionment shall be conclusive," urging that singly and collectively their exercise will permit substantial invasion of the remainder interest to the detriment of the remainderman and benefit of the life tenant. The government finds further significance in the provision that the corporate trustees' annual accounting need be made only to the life beneficiary. To illustrate how substantial invasion may occur, the government suggests, in regard to the power to invest in any type of property in any proportion, the possibility that the trustees may invest in a wasting asset without making provision for amortization of the asset or other reserve for the return of corpus. In regard to the power to allocate and apportion expenses and receipts, the government contends that this power may be used to divert corpus to the income beneficiary if the trustees, in the exercise of their uncontrolled discretion, charge a premium on securities purchased at a premium to corpus, but treat the full return on such securities as income payable to the life beneficiary. The government also suggests

that the trustees, in the exercise of their uncontrolled discretion, could elect to allocate stock dividends to the income beneficiary so that, again, a portion of the value of the corpus would be diverted to the noncharitable life income beneficiary. Finally, the government argues that the trustees might even allocate capital gains to income but capital losses to principal since they are vested with "uncontrolled discretion" to make allocations, notwithstanding that both gain and loss on the sale of investment assets would ordinarily be allocable to corpus, Edgecombe Bank & Trust Co. v. Barrett, 238 N.C. 579, 78 S.E.2d 730 (1953).

The law of North Carolina, as elsewhere, is that, short of an intention to achieve illegal objectives, the intention of the testator-settlor should prevail, and in determining that intent a court will look at all of the language employed as well as the attendant circumstances. Campbell v. Jordan, 274 N.C. 233, 162 S.E.2d 545 (1968); Callaham v. Newsom, 251 N.C. 146, 110 S.E.2d 802 (1959); Wachovia Bank & Trust Co. v. Steele's Mills, 225 N.C. 302, 34 S.E.2d 425 (1945). Here, the manifest intent by plaintiff and her husband was to retain a life interest in income for themselves, and the survivor of them, but only to the extent of maintaining their accustomed mode of living, with a remainder for charity. Not only did plaintiff, the surviving life tenant, act as one of the settlors of the inter vivos trust, naming herself as one of the trustees, she entered into a contract that she would transfer substantially all of her property to the trust upon her

husband's death (if she survived him) and that she would execute a will leaving her residuary estate to the trust. There is thus a strong evidence of an intention to create, preserve and protect an admittedly charitable remainder.

In addition to the circumstances surrounding the establishment of the trust and creation of the charitable remainder, the intention of the settlors with respect to invasion of corpus for themselves is manifest from the express language granting the power to invade, which they employed. They authorized invasion to maintain their standard of living, or that of the survivor — a recognizable and enforceable standard — and directed that invasion be undertaken only after consideration of their, or the survivor's, other sources of income and capital resources. This express power to invade has both its positive and negative implications. Not only does it permit corpus to be advanced to them under the conditions stated, it also manifests an intention that corpus not be used for the benefit of them, or the survivor, except under the conditions stated. Cf. Campbell v. Jordan, supra, 162 S.E.2d at 551. The specific intention embodied in their express power, in our view, limits the more general powers granted to the trustees. That is to say, the trustees, in exercising their general powers of administration, must exercise them within the framework of the overall intention of the settlors as they expressed it.

North Carolina is not hesitant to exercise judicial control over private trusts, including private

charitable trusts, not only to enforce them but also to protect the rights of persons having an interest therein. First-Citizens Bank & Trust Co. v. Rasberry, 226 N.C. 586, 39 S.E. 2d 601, 603 (1946) (dictum), and the subsequently cited cases adjudicating the rights of beneficiaries with respect to one another and to their trustees. The Attorney General of North Carolina has express statutory and common law authorization to enforce charitable trusts. N.C.G.S. §§ 36-19 and 36-20 (1966); Steinberger v. Tannenbaum, 273 N.C. 658, 161 S.E.2d 116 (1968).

North Carolina has explicitly referred approvingly to the rule that a trustee must deal impartially with the beneficiaries of a trust in Campbell v. Jordan, supra, 162 S.E.2d at 551, and it has done so impliedly in numerous cases. This is the general rule, Restatement (Second) of the Law of Trusts § 183 (1959); and, to our knowledge, it has not been rejected by the courts of any state. While North Carolina may have infrequently exerted judicial control over the manner in which discretionary powers of trustees have been exercised, it has not hesitated to do so in an appropriate case. Albright v. Albright, 91 N.C. 220 (1884); Carter v. Young, 193 N.C. 678, 137 S.E. 875 (1927); Woodward v. Mordecai, 234 N.C. 463, 67 S.E.2d 639 (1951); Dillon v. North Carolina National Bank, 6 N.C. App. 584, 170 S.E.2d 570 (1969). See also, Lightner v. Boone, 222 N.C. 205, 22 S.E.2d 426 (1942), aff'd, 319 U.S. 561 (1943). Albright and Carter equate an abuse of discretion on the part of a trustee with "fraud" or "bad faith" or "improper motive," but they are important

because of their recognition that these invidious labels apply to action clearly contrary to the intention of the settlor of a trust as well as to acts of moral or tortious legal impropriety. Their repeated citation in the later authorities attests to the continuing viability of this concept. As recently as the decision in Little v. Wachovia Bank and Trust Company, 252 N.C. 229, 113 S.E. 2d 689 (1960), the court, in stating the general rule that a trustee's exercise of a discretionary power will generally be upheld in the absence of fraud or arbitrary action, added the caveat "[o]f course the trustee will not be given 'unlimited power to make allocations as between income and principal in contravention of the intent of the settlor as indicated by the terms of the trust instrument as a whole.' Annotation: 27 A.L.R. 2d, Income and Principal, p. 1325." 113 S.E.2d at 708.

We have not found, nor has there been cited to us, any North Carolina case dealing explicitly with the limits of the "absolute direction" vested in the trustees to allocate and apportion expenses and receipts between the interests of the beneficiaries and the circumstances, if any, under which their exercise of the power will be judicially controlled. Ordinarily a settlor's use of such language, with or without the further protection that the trustee's exercise of the power shall be "conclusive" — present here — is treated as conferring even greater authority on the trustee than a simple and unqualified grant of discretion. Restatement (Second) Law of Trusts § 187 (1959), comment j, pp. 408-409; Scott, The Law of Trusts § 187, p.

1502 (3rd ed. 1967). These authorities recognize that the addition of such language dispenses with the otherwise applicable test of "reasonableness," but they do not fail to add that a trustee is not thereby given unlimited discretion and his exercise of "absolute discretion" is still circumscribed by the intention of the settlor. We have little doubt that North Carolina would pay close attention to the intention of a settlor in determining whether a trustee exceeded his authority in exercising a grant of "absolute discretion." We, therefore, conclude that in this case North Carolina would permit the exercise of "absolute discretion" to apportion and allocate expenses and receipts only within the framework of the settlor's intent to invade the charitable remainder only to the extent of maintaining the settlor's accustomed mode of living. And in this case, inasmuch as the surviving life beneficiary — the wife — is one of the trustees, our view is reinforced with respect to the exercise of this power, as well as any other which may be capable of being exercised to prefer the life beneficiary over the remainderman, by the stringent limiting rules of conduct which govern a trustee's acting for his own benefit. Wachovia Bank and Trust Co. v. Johnston, 269 N.C. 701, 153 S.E.2d 449 (1967).

To supplement this expression of what we perceive general North Carolina law to be, we need add only a few comments in response to specific arguments advanced by the government. With regard to the treatment of stock dividends, the trustees' powers of allocation are sufficiently broad to permit them to classify stock dividends

either as corpus or as income. But we think the matter of little moment. In North Carolina, absent an express power of this breadth, stock dividends would be treated as principal. N.C.G.S. § 37-5(a) (1966). This is ordinarily called the Massachusetts rule. But in many states the rule at common law is to the contrary and requires a determination of the portion of the stock dividend attributable to income and the portion attributable to corpus and the various portions to be charged accordingly. This is generally referred to as the Pennsylvania rule. Taggert, Charitable Deductions for Transfers of Remainder Interests Subject to Invasion, 21 Tax L. Rev. 535 (1966). In oral argument, the government candidly admitted that in states following the Pennsylvania rule, the government would not contend that the deductibility of an otherwise deductible charitable remainder would be lost thereby. We cannot see, therefore, how the trustees' power in the instant case, taken alone or in conjunction with their other powers, should make any difference in the decision of this case.

With regard to the trustees' power to purchase an annuity on the life of the life beneficiary, we do not think that under the general law stated, on the facts of this case, that the trustees could use any substantial portion of the corpus to purchase an annuity, or any other wasting asset, without making provision for the establishment of a reserve to reimburse corpus or to amortize the depreciation thereon. Indeed, with respect

to annuities, N.C.G.S. § 36-4.1 (1966) requires specific court approval as a condition precedent to the purchase of a single premium annuity by a trustee even from income. We would view it very unlikely that judicial approval would be readily forthcoming here without amortization of any principal employed to pay the premium where the life tenant requires $5,500.00 to maintain her accustomed mode of living but is receiving over twice that amount. The statute has not received judicial construction, but we think it equally unlikely that it could be avoided by the trustee here in the absence of a specific reference to it by the settlors and specific authorization to the trustees to avoid compliance with it. Our conclusion is the same with regard to the purported power to charge the premiums paid on securities purchased to corpus, while treating the entire return, except repayment of principal upon maturity, as income,[5] and the purported power to treat capital gains as income while treating capital losses as chargeable to principal in contravention of Edgecombe Bank & Trust Co. v. Barrett, supra. Under this trust when the settlor's full intention is given effect, we do not think that preferment of the life beneficiary by the exercise of these powers would receive judicial approval.

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5. We note that absent the express power in this trust, N.C.G.S. § 37-6 (1966) would appear to require charging both the premium paid on a security purchased and any loss realized upon maturity to principal. Any exercise of the power in derogation of the statute could, therefore, only aid in the preservation of the charitable remainder.

Appendix A - Opinion

To summarize, we conclude that, under the law of North Carolina and on the facts of this case, the legal right of the trustees to effect an indirect diversion of corpus to the detriment of the charitable remainderman under their general powers of administration is so limited and restricted that it cannot be said that the charitable remainder was not "presently ascertainable" at the date of the husband's death or that "the possibility that the charitable interest will not become effective" is other than so remote as to be negligible. We, therefore, agree with the district judge that the charitable deduction claimed by the plaintiff should be sustained.

REVERSED IN PART;
AFFIRMED IN PART.